

**California Commission on Tax Policy  
in the New Economy**

El Segundo  
May 22, 2003

Proceedings

## **MAY 22, 2003: EL SEGUNDO**

### Welcome Remarks

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Dombrowski

### DBS Taxation Issues

Michael McDonnell - Senior Vice President & Chief Financial Officer, EchoStar

Michael Palkovic - Senior Vice President & Chief Financial Officer, DirecTV

Randy Dryden – MBIA MuniServices Company

Jeffrey Sinsheimer – Member of the Public

Don Nadeau – Member of the Public

### Interim Report - Objectives for the Options Report

Scott Farris – Governor's Office of Planning and Research

### Non-Residential Property Re-Assessment

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Sunne Wright McPeak, Ex-Officio Commissioner

### Scott Peters – Proposal 1

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### Letters to the Commission: DBS Taxations

California Space Authority - Letter in Response to the Interim Report December 16, 2002

Testimony of Michael McDonnell

Testimony of Mike Palkovic

Letter to Governor Davis – In Response to the Options Report

**MEETING OF THE  
CALIFORNIA COMMISSION ON TAX POLICY IN THE NEW ECONOMY**

**[www.caneweeconomy.ca.gov](http://www.caneweeconomy.ca.gov)**

El Segundo Community Library  
111 W. Mariposa Avenue  
El Segundo, CA 90245  
(Library Park)

May 22, 2003  
AGENDA

- |          |   |
|----------|---|
| 9:30 AM  | Chairman Bill Rosendahl<br>Meeting called to order<br>Announcements<br>Roll Call and Introductions (as appropriate) |
| 9:45 AM  | Honorable Richard Riordan, Former Mayor, City of Los Angeles  |
| 10:00 AM | California Space Authority<br>Mike Palkovic, CFO Direct TV<br>Mike McDonnell, CFO Echo Star<br>DBS Taxation Issues  |
| 10:45 AM | Scott Farris<br>Objectives for the Preliminary Report<br>Begin Proposal Discussions / Evaluations                   |
| 11:45 AM | Break for Lunch   |
| 1:15 PM  | Continue Proposal Discussions / Evaluations   |
| 3:30 PM  | Content of the Final Report<br>Meeting dates, themes, and locations for 2003  |
| TBD      | At the discretion of Chairman Rosendahl<br>Public commentary<br>Adjournment   |

Agendas for public bodies supported by the California Technology, Trade and Commerce Agency, are available at <http://commerce.ca.gov>. For additional information regarding this notice, please contact Marshall Graves, California Technology, Trade and Commerce Agency, 1102 Q Street, Suite 6000, Sacramento, CA, 95814, (916) 445-7654, [mgraves@commerce.ca.gov](mailto:mgraves@commerce.ca.gov)

## **Brewer – Property Tax Loophole**

Proposal: Recommend to the State Legislature than existing “loopholes” be closed, rather than resort to the current plan circulating to create a “split roll.”

### 1. Fairness:

In 1978, Californians overwhelmingly passed Proposition 13 because of escalating and excessive property taxes. It was a citizen inspired initiative to ensure that families wouldn't lose their homes due to heavy taxation. It is a successful fair & equitable tax. Business benefits from knowing exactly the annual increases to their tax bills. If a split roll is passed - and it will need to go back to a vote of the people - costs to commercial & retail businesses and apartment owners will be passed on to tenants and consumers.

### 2. Simplicity:

No one has addressed this part of the equation! There will be costs involved in annual or biannual commercial and industrial property inspections and reassessments. Additional staff will need to be hired by Counties to handle the workload. Assessment Appeals hearings will increase by a hundredfold.

### 3. Efficiency:

The issue becomes very complex with publicly traded companies. More than 50% of their stock can be traded in any one business day. Should this generate a “Title Change” on their corporate headquarters? Also, it is incomprehensible that a commercial building held by a family owner business for some 20 years will suddenly be taxed at today's market value. The vast majority of businesses in California are Mom & Pop operations...”small business.” Many own their incubators or small units in an industrial mall. This measure will have the potential of putting them out of business or cause them to flee the state.

### Closing Comments:

There are statutes on the books that can be rescinded that can generate an adequate amount of property taxes. One of the most prominent is the 1031 Exchange. A party can “sell” a property and during escrow, identify a similar property, purchase it with the proceeds and RETAIN the tax base from the original property. Another is a “Senior” benefit where you can transfer your lower tax rate to a new residence (live there 1 year) and transfer that original lower tax rate to another new residence. All of this flies in the face of the tenets of Proposition 13 and were implemented after Prop 13 passed. Other avenues exist rather than chasing more business out of California due to split rolls and excessive worker's comp.

## **Brewer – SSTP Observers**

Proposal: That California representatives attend and participate in the SSTP as observers and not become voting members.

### **1. Fairness:**

A recent study claims that California has missed out on \$1.75 billion in sales tax revenue in 2001. That amount comes to just 0.06% of the entire budget deficit for the next eighteen months. SSTP is NOT the answer to our egregious deficit. When a minimum of 10 states, representing 20% of the USA population *have amended their constitutions* to comply with the SSTP proposal, Congress will be petitioned to pass laws conforming the entire nation. Real fairness will prevail when this matter is addressed by the Congress and becomes a national policy....not piecemeal with certain states participating. Action is being taken in Washington D.C. - as we speak - to make the Internet Tax Freedom Act permanent. Fairness? We are the 5th or 6th largest economy in the world... yet, under SSTP we would have one vote and buying into a proposal that is 85% complete.

### **2. Simplicity:**

At first blush SSTP looks to be the answer to taxation simplification. Yet, this proposal will require an overhaul to our sales and use tax. One example; under SSTP, prescription drugs, now not subject to Calif. sales tax, is taxable under SSTP.

### **3. Efficiency:**

The effects on local entities contains both pluses and minuses. Most important...as our own Board of Equalization stated, "Conformity does not result in additional taxes being collected," which is one of the objectives.

### **Closing Comments:**

SSTP is a (not so veiled) attempt to standardize sales taxes nationwide creating a uniform opportunity to tax the Internet. For California to encourage Internet taxation would be an economic suicide attempt. What is left of the Silicon Valley would be greatly jeopardized. Our national leadership in Internet technology, switching systems, computers and chips could disappear. Taxing something brings less of it. Taxing the Internet while it is still so young is infanticide!

## **Dombrowski – SSTP Observers**

The Streamlined Sales Tax Project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The Project's proposals include tax law simplifications, more efficient administrative procedures, and utilizing emerging technologies to substantially reduce the burden of tax collection. Once at least ten states representing 20% of the U.S. population have amended their laws to comply with the SSTP's final product, the Project's participants will petition Congress to address the issue of remote sales, hopefully concluding with a level playing field for remote sellers and bricks-and-mortar in regards to collection of sales taxes.

Proposal: Encourage the legislature to pass and the Governor to sign legislation authorizing California's participation in the SSTP.

Analysis based on guiding principals:

### **1.Fairness**

Remote sellers currently are not required to collect state sales taxes while those retailers with a physical nexus in the state are required to collect such taxes. This results in an unlevel playing field. While customers of remote sellers are required by law to pay use taxes on such purchases, few do. According to a 2002 study, California missed out on \$1.75 billion in sales tax revenue in 2001 because of this situation. Participation by California in the SSTP is the first step to eventually providing fairness to retailers with a physical presence in the state.

### **2.Simplicity**

Currently there are approximately 7,500 different sales tax collection districts in the United States, all using a wide variety of rates and definitions. The Project's goals are to provide uniform definitions, rate simplification, ease of administration, simplified exemptions, and uniform audit procedures. The ultimate objective is to provide a system that allows for easy collection and compliance on the part of all sellers and government entities.

### **3.Efficiency**

Compliance with the SSTP's final product will allow for a slightly more predictable sales tax base for the state since it will stop the leakage that is resulting from the growth of remote sales. Administrative burdens on the state will also be improved. Funding for local services, including fire and safety protection, will also be protected.

From: Scott Farris [Scott.Farris@OPR.CA.GOV]  
Sent: Wednesday, May 21, 2003 9:28 AM  
Subject: Interim Report

Importance: High

All:

Staff's apologies that you do not have a draft of the interim report in advance of tomorrow's meetings, but several things came in late and it is lengthy besides. We will, instead, bring copies in loose leaf binders to facilitate editing.

At this point, staff recommends (I emphasize recommends since the decisions are yours) the following outline for the report.

Section 1. Introduction discussing why this second interim report is being produced and what the Commission has done since December 2002.

Section 2. A brief discussion of the "methodology of assessment." This discusses how the Commission decided that Commissioners would develop potential options and then score them - somewhat along the lines recommended by Joint Ventures Silicon Valley (JVSV).

Section 3. This will be the list of options - in a slightly different format than submitted. Staff tried to preserve as much of everyone's original language as possible, but placed it in the matrix which I explained to you in a previous memo. The nine options submitted are:

- \* Periodic reassessment of commercial property.
- \* The flat rate income tax and VAT,
- \* The DBS tax.
- \* A single statewide telecommunications tax.
- \* Creating tax courts.
- \* Lowering the voter threshold for voter approval of local tax measures.
- \* Constitutional protection of local revenues.
- \* Joining the SSTP.
- \* Swapping state and local tax revenues.

Section 4. This brief section describes how the Commission intends to complete its work over the coming year.

Section 5. Commissioner Rossman has submitted extensive comments, using the JVSV to "score" California's current tax system. If the Commission chooses to use that material, it could be placed here to provide context for the options.

Section 6. Appendices. What we suggest:

- \* List of commissioners with bios.

- \* List of ex-officio members.
- \* List of presenters at all meetings in 2003 so far.
- \* Copy of the enabling legislation.

Again, I repeat, whether you want to add, subtract or change anything is up to the Commission, not staff. We look forward to your discussion and comments tomorrow in El Segundo.

Scott



Date: April 28, 2003

To: Members, California Commission on Tax Policy in the New Economy

From: Joel Fox

**Re: Tax Policy Commentary**

Scott Farris has asked for a brief perspective on three tax policy areas under discussion by the Commission: 1) Property tax for sales tax swap; 2) Lowering vote requirements for local tax increases; 3) Split roll property taxes

**PROPERTY TAX SWAP**

Proposition 13 called for property taxes to be “apportioned according to law.” This phrase was interpreted by the Legislature to mean that it had the power to dictate how property tax revenues could be directed.

The California Supreme Court considered the loss-of-home-rule argument in the *Amador* case in 1978, in which the court declared Proposition 13 constitutional. The Court declared this concern ill-founded. The Court said the Legislature already had control over property taxes and pointed out examples in the state constitution such as granting property tax exemptions. However, it is clear over time the Legislature has taken advantage of this clause to dictate the use of property tax revenue. When the Legislature directed property tax payments to the schools with the ERAF legislation of the early 1990s, even the Howard Jarvis Taxpayers Association filed a friend-of-the-court brief in support of a Los Angeles County lawsuit. The HJTA brief stated it was not the intent of Proposition 13 to allow the state to raid the property tax.

The property tax for sales tax (or the vehicle license tax is another option) swap is intended to keep more property tax at the discretion of local officials. The swap is also intended to give an incentive for local government to approve residential and manufacturing developments instead of sales tax producing projects.

Focus is on the Darrell Steinberg-John Campbell proposal, AB 1221. A plan to swap .5% of the local sales tax for a like amount of property tax was also proposed five years ago by the Speaker’s Commission on State and Local Finance. As a member of that Commission, I voted for the plan. Such a swap would improve the options and control for local government. A bolder plan, Orange County Supervisor Chris Norby’s “F.R.E.S.H.” proposal, would swap all local sales tax and all the VLF tax for an equal amount of property tax.

Opposition to a swap plan would likely come from high-sales-tax cities and probably from the schools. The high-sales-tax-cities want to keep in place a system they have made work for them. Schools may not want to see property tax replaced with state

general fund money. Studies have shown property taxes increasing slightly faster than sales taxes over the past decade.

How will the average taxpayer view this swap proposal? I believe they will be positive. Members of the public believe property tax is a local tax. I recall clearly informed citizens opposed ERAF once they understood that it meant property taxes were being shifted away from local governments. I would expect support from taxpayers for a swap, however, that could be tempered depending how strongly the school establishment opposes the reform, if it chooses to do so.

## **TWO-THIRDS VOTE FOR LOCAL TAXES**

The current constitutional requirement of a two-thirds vote of the people for raising local taxes was established by Proposition 13. Seeking a two-thirds vote for deciding important issues has a longer history. A two-thirds vote requirement can be found ten times in the United States Constitution, including the two-thirds vote needed to override a presidential veto or approve a treaty. Similarly, the two-thirds vote appears a number of times in the state constitution. A legislative two-thirds vote for some tax increases appeared and then disappeared from the California Constitution prior to Proposition 13. Governor Ronald Reagan tried to re-establish a two-thirds vote to raise taxes in the Legislature with his unsuccessful Proposition 1 in 1973.

The two-thirds vote of the people to raise taxes to support local general obligation bonds appeared first in the 1879 California Constitution. Proposition 13 demanded a two-thirds vote to raise taxes as part of its overall tax reform. When this provision of Proposition 13 was legally challenged, the California Supreme Court recognized that the initiative's intent for overall tax relief would not be achieved if reduced property taxes could easily be replaced by other taxes.

The two-thirds vote requirement has been controversial from the start with critics arguing that it is undemocratic, one "No" vote should not off-set two "Yes" votes. It has also been argued that any requirement authorizing a vote of the people interferes with the government officials' ability to manage local budgets effectively. On the other hand, as has already been noted in this essay, the two-thirds vote is an established and recognized device in democratic government. The two-thirds vote standard offers some sense of consensus on tax raising issues, particularly when off-time elections see low voter turnouts meaning under a majority vote standard a tax on all the people could be raised by, say, 5% of registered voters who vote at a low turn-out election. Nobel-prize winning economist Milton Friedman said that the two-thirds vote was probably the most important feature of Proposition 13.

Included in this debate is a discussion of the current standard of requiring a simple majority vote for a "general" tax increase versus a two-thirds vote for a "special" tax increase.

First a history: Proposition 13 called for a two-thirds vote of the people for “special taxes.” It was the intent of Proposition 13’s authors that the term “special taxes” cover all local tax increases. However, the term was not defined in the measure. In the case of *San Francisco v Farrell* (1982), a friendly lawsuit between the city and one of its officers, the California Supreme Court determined that “special taxes” referred to taxes set aside for special purposes, say for police services. The court declared that since Proposition 13 did not discuss “general taxes” that no vote at all was required for tax revenues to be placed in the city’s general fund. Recognizing the difficulties in raising general taxes, supporters of Proposition 13 accepted the court’s definitions; however, they put on the ballot a requirement that general taxes receive a majority vote. Twice the people of California approved statewide ballot initiatives upholding the concept of a majority vote for “general” taxes and a two-thirds vote for “special” taxes, Proposition 62 in 1986 and Proposition 218 in 1996.

It has been argued that the tax definitions should be flipped. In other words, general taxes should require a two-thirds vote because the voters do not know specifically how the governing body will spend the new tax dollars so such a request for funds should be made more difficult. Special taxes then should require a simple majority vote because the governing body is, in a sense, contractually obligated to spend the tax revenue for the special purposes officials declared they needed it for when the tax was placed on the ballot. The problem with this argument is that government money is fungible. Likely, all that would appear on the ballot would be special tax measures for services favored by the public. Then revenue raised for a specific purpose, again, use police services as an example, could displace general fund revenues used for police services thus freeing up those general fund dollars to be used as the governing body chooses, usually for less publicly favored items. A change in the vote requirements for general and special taxes most probably would quickly lead to heavier tax burdens.

How do the people look at the two-thirds vote requirement for local taxes? For the most part, the voters support the two-thirds vote requirement. The provision to lower the two-thirds vote to 55% for local bonds for school construction did pass in 2000. However, it should be noted that this was accomplished after two attempts to lower the vote requirement over a short, sixth month period in which over \$50-million was spent promoting the idea; the vote change was to advantage schools, continually ranked the number one priority of California voters, and the narrow 53%-47% electoral success was accomplished in much better financial climate.

## **SPLIT ROLL**

When Howard Jarvis was asked if he gave business a benefit by allowing business property to be taxed the same way as residential property under Proposition 13 he answered that business property had been treated the same as residential property for property tax purposes for 50 years in California and if business were given a break the Legislature had given it to them long ago.

Other states have split rolls and the splits can be numerous, dozens of different categories. This often occurs when special interests argue for benefits for their type of property. There are many ways to split the roll, including attaching different tax rates to business property. Under current discussion in the Legislature are two plans. One would reassess business property (except agriculture) at full market value every year. This would require a constitutional amendment. The other would statutorily change the way “change in ownership” is defined for business property.

This Commission has heard the arguments over the split roll. What effect will it have on business and the economy? What side of the split should apartment buildings fall? What happens to mom and pop operations if all business property is reassessed every year, and along those same lines, what happens to the small business that may lease space in a building owned by a big cooperation, which would be reassessed under a change in ownership law change and pass the tax increase along to the small businesses under the lease’s provisions?

I believe the change in ownership provision for business will be hard to do legally without changing the Constitution. As noted in Commission hearings, some corporations stock turns over every few days making the turn-over-of-stock standard to define a change in ownership nearly impossible to measure. Further, the Constitution *requires* property to be reassessed on change of ownership. Creating a cycle with an assumed change in ownership over a two, three or five year period I believe would not pass constitutional muster and could only be established with a constitutional amendment.

How do voters see a split roll? I think that is hard to say. The business community has been effective in the past arguing that a split roll will be a job killer and voters do not want to hurt the economy. Voters have had one opportunity to vote on a split roll. Proposition 167 of 1992, sponsored by Commissioner Goldberg, in part, would have taxed commercial property differently than residential property. The measure was defeated, however, this occurred in the shadow of the record \$7-billion state tax increase signed by the governor the previous year.

Date: April 28, 2003

To: California Commission on Tax Policy in the New Economy

From: Joel Fox

**Re: Scoring of the Laffer Proposal**

Dr. Arthur Laffer's proposal for a new California tax structure, *A Flat Rate Tax for California State and Local Governments*, is described in his April 23, 2003 paper distributed to the Commission. The key components of the plan: Eliminate all current taxes in California except for "sin taxes" and establish two new taxes, a flat rate personal income tax and a flat rate business value-added-tax. According to Dr. Laffer's calculations, the revamped tax structure with a 6% tax rate would replace, on a revenue neutral basis, the \$120-billion now generated by California's state and local taxes.

**FAIRNESS AND PERCEPTION**

*1—Equity and Fairness.*

The tax is uniform meaning that all taxpayers pay the same rate and are treated the same. Such a plan treats everyone equally, however, those who believe in progressive tax rates may question the plan's fairness. By reducing the number of deductions for income tax payers, but allowing both a deduction for rent as well as mortgage payments, many would consider this plan equitable. The rating of this category really falls on "fairness" being in the eye of the beholder. Rating: +/-.

*2—Transparency and Visibility.*

Individuals and businesses would be aware of their income tax or value-added tax liability, and with reduced deductions could easily figure out their tax obligation. Rating: +

*7—Minimum Tax Gap*

This plan is specifically designed to increase tax compliance by having a simple, broad-based, low tax rate for individuals and businesses to comply with. Rating +

*9—Neutrality*

By reducing exemptions, with notable exceptions of charitable donations and mortgage and rent deductions, this plan removes tax implications from most transactions. However, business may react to the value-added tax provisions by bringing certain services in-house rather than contracting for those services, thus avoiding a value-added tax on those particular services. Rating: +/-

**SIMPLICITY**

*3—Certainty*

As long as the tax rate is set and not changed there is certainty for taxpayers. Rating: +

#### 4—*Convenience of Payment*

Personal income tax and business value-added-tax would be due on a regularly scheduled basis. Rating: +

#### 5—*Economy in Collection*

The cost of complying for the income tax payer should not change from the current situation. Business will need to change procedures to calculate the value-added-tax instead of current corporate and personal property tax collection as well as other taxes. In the end, this should be easier for business. Rating: +

#### 6—*Simplicity*

By reducing the income tax to one rate, the current income tax system will be immensely simplified. Business will also enjoy simplicity in paying a flat rate value-added-tax. Rating: +

### EFFICIENCY/BALANCE

#### 8—*Appropriate Government Revenues*

Relying on basically two major taxes, the state may not know what to expect in revenue since the income tax is volatile and would make up a larger portion of the tax system than it does presently. Further, while Dr. Laffer believes that replacing the current tax structure with a 6% income and value-added tax will bring in an equal amount of revenues, even he admits that the uncertainties of tax calculations could mean that the initial tax collection could be off. However, as Laffer says, the new tax system will create a dynamic change for the economy bringing in more revenue soon and into the future. Rating: +/-

NOTE: Per Commissioner Weintraub's request, I asked Dr. Laffer about transition plans between the old tax structure and the new. Laffer said he wanted to write a paper on a transition proposal, which he will do when he returns from a business trip.

#### 10—*Economic Growth and Efficiency*

The plan is designed to encourage economic growth and efficiency. By lowering the top personal income tax rates concerns that high-end taxpayers will leave the state to avoid excessive taxation should end. Rating: +

From: Graves, Marshall [MGraves@commerce.ca.gov]  
Sent: Wednesday, April 30, 2003 9:35 AM  
To: 'marshall.graves@opr.ca.gov'  
Subject: FW: Non-residential property re-assessment

Lenny Goldberg

Subject: Non-residential property re-assessment

Periodic re-assessment of non-residential property

This proposal would distinguish between residential and non-residential property, and periodically re-assess non-residential property to market value. I've attached far more extensive material, much of which you've already seen and perhaps read.

1. Fairness: "similarly situated taxpayers should be taxed similarly". Very similarly situated businesses who compete with each other and receive the same public benefits, but face widely differing property taxes, as high as 10-1 and more per square foot. In their court challenge Macy's found identical property taxed higher than its competitors in the same shopping center. The vagaries of "change of ownership" are different for each business, and really have nothing to do with the basis of taxation. The current system fails miserably on this criteria.

2. Simplicity: "The tax law should be simple so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner". Current re-assessment rules fail miserably on this score. The definitions of when change of ownership occurs are incredibly complex, and subject to manipulation. While the extensive report we received from the Board of Equalization pointed out the many ways re-assessment can be avoided despite apparent changes of ownership, they also noted that taxpayers are often caught in a re-assessment position that they were unaware of because of "two-stage" transactions. The statute and the application of it are relatively impenetrable, so the current system fails once again.

With regard to the alternative, re-assessment, this would reinstate what is the traditional system for assessing value, which is in effect in every other property tax state. The rules and the methodologies are clear, and, while there are judgment calls, taxpayer compliance is a relatively simple matter.

3. Efficiency: "The tax system should not impede or reduce the productive capacity of the economy". Our system inflates the value of land at the expense of productive investment. By providing continually declining holding costs on the value of land and real property holdings, we increase land values and therefore the cost of construction and development. In fact, the burden of taxation ends up disproportionately on new investment, who not only pay full market value but also fees, exactions, easements and mitigations, and does not tax those who benefit from the investment of others, that is, the landholders who accumulate untaxed windfall land rents. All economists will agree, as

those at our meeting did, that taxation of the increased value of land and property, particularly investment property, is a relatively neutral and efficient way to tax. It does not affect the investment decision in any way except perhaps positively, that is, increases the intensity of property utilization, and is a highly efficient, “neutral” tax.

While the proposal for re-assessment increases economic efficiency, there has been a stated concern from the business community about the overall tax burden. Based on these efficiency principles, we would note that the placement of new equipment in service in manufacturing or in other investments is taxed both at the sales tax level and at the personal property level. Consistent with these principles, we think that efficiency, simplicity, and fairness could be served by a trade-off, at least in part, with regard to real property tax and personal property tax.

Here's the article, with summary points at the end.

<http://www.caltaxreform.org/infrastructure.htm>

<http://www.caltaxreform.org/infrastructure.htm>

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## **Rosendahl – DBS Tax**

Proposal: Impose a statewide tax on Direct Broadcast Satellite (“DBS”) service that approximates the tax and fee burden on cable television operators and subscribers.

Analysis based on guiding principals:

### **1. Fairness**

Currently, the DBS industry, with over 1.6 million California subscribers, has almost 20 percent of the multi-channel video market. DBS companies generate gross revenue of over \$1.5 billion in California. Neither DBS companies nor subscribers pay State or local taxes. By contrast direct competitors to DBS, Cable TV operators, and 8 million Californians who subscribe to cable pay over \$300 million in local taxes, utility fees and local franchise fees on revenues of \$3.8 billion. Cable companies pay an average of 8 percent of their revenues in franchise fees, property taxes and utility user taxes to local governments.

An 8 percent tax on the total gross of a DBS subscriber's monthly bill is an equitable solution to ensure that similarly situated taxpayers are taxed similarly. A tax on subscribers and collected by DBS operators through subscribers' bills would provide for transparency and visibility by delineating that the tax exists and how and when it is imposed upon them and others. Like currently existing sales and use taxes, it can be structured to minimize non-compliance. Most importantly, a tax on DBS provides competitive neutrality in an important area of the new economy by balancing the burdens between providers of multi-channel video service: tax differences would no longer play a role in a taxpayer's decision to choose cable or DBS.

### **2. Simplicity**

A tax on subscribers and collected by DBS operators through subscribers' bills at a set rate meets the principle of simplicity. It can be certain by clearly specifying on the bill when the tax is to be paid, how it is to be paid, and how the amount to be paid has been determined. A tax paid by a subscriber at the time of payment of a DBS bill will be at a time or in a manner that is most likely to be convenient for the taxpayer. It will also permit taxpayers to understand the rules, and comply with them correctly and in a cost-efficient manner. Collection by the DBS provider and remittance to the State will keep the costs to collect a tax to a minimum for both the government and taxpayers.

### **3. Efficiency**

In terms of efficiency as defined by stable tax base and economic growth, a tax that equalizes that burden between cable and DBS will give the State a reliable revenue base: migration of customers to DBS will no longer result in decreased revenues because, even if local governments are losing tax and fee revenues, the State tax will neutralize any overall revenue reduction. A DBS tax will also promote economic growth by encouraging competition based on innovation and consumer satisfaction, not tax and fee differential.

Other considerations:

Recommendation of a DBS tax is consistent with the Commission's charge under Revenue and Taxation Code Section 38065. Under federal law, the State may, and local government is prohibited from, imposing a tax on DBS. (See section 602(c) of the Federal Telecommunications Act of 1996) California added Part 15 to the Revenue and Taxation Code many years ago to ensure tax parity between cable companies and other providers. However, that code has not been amended to keep pace with the DBS industry. Fourteen other states, including Florida and taxes, tax DBS service at rates ranging from 4 percent to 13.17 percent.

## **Rosendahl – Single Utility Tax**

### **Proposal: Statewide Communications Simplification Tax**

**Description:** Combine all State and local taxes, fees and surcharges charged on providers of electronic communications services (e.g.; telephone companies, cellular companies, cable television companies, satellite companies) and their customers into one statewide tax on customers' communications bills collected by the distributors and allocated by the State Board of Equalization to State and local jurisdictions currently receiving revenues from existing taxes, fees and surcharges on a revenue-neutral basis.

**Critical New Economy Issue:** Digital communications is at the heart of the New Economy. One important result is convergence: monopolies, legal or perceived, are falling: providers, which traditionally offered only one service, are now capable of offering multiple service subject to various tax and fee obligations; and, technology is rapidly offering a whole host of new alternatives to providers and consumers. Increasingly, the federal government, the State and local government regulation of providers and services is put at issue by deployment of new technologies to meet consumers' desires. Simply put, taxes, fees and surcharges on communications predate the internet-or the Internet tax freedom acts, and no one can reasonably predict future market choices consumers will make and the consequences for State and local taxes and fees. For example, will traditional telephone markets be altered significantly by cellular or IP telephone? Or, will WiFi technology displace landline broadband market share? Or, what will the impact of bundling of services by a single provider into a single rate when those services are subject to different taxes and fees at the State and local level?

Old paradigm taxes, fees and surcharges on communications providers and consumers designed to meet the revenue needs of the State and its political subdivisions-including, but not limited to franchise fees, utility user taxes, property taxes, and CPUC telephone surcharges-are premised on monopolies offering discreet services with stable technology. They, therefore, cannot insulate the State's revenue base from technological change, competitive choice or regulatory flux, and call for consideration of structural reform.

**Guiding Principals:** Any wholesale change in communications taxes must achieve the goals of fairness, simplicity and efficiency. A single statewide tax in lieu of the multiple taxes currently imposed on communications can be fair, by ensuring that tax differences would no longer play a role in a consumer's decision to choose a provider or technology, and simple, by permitting taxpayers and providers which collect taxes to understand the rules, and comply with them correctly and in a cost-efficient manner. A single tax system can be highly efficient by insulating State and local tax revenues, broadening the tax base, eliminating multiple tax filings, and giving providers the greatest flexibility to deploy technologies and services with certainty as to the burdens associated with such offerings. This will encourage investment in California infrastructure and customer choice.

Considerations: Consideration of a Communications Simplification tax is consistent with the Commission's charge under Revenue and Taxation Code Section 38065. Florida has already put such a tax in place. See, Communications Services Tax Simplification Law, Taxation and Finance Code, Title XIV, Chapter 202. As Florida experience demonstrates, structural reform is a time consuming process. It took two years for the State, local government, industry and interested parties to agree on the final form of the legislation. In California, such structural reform a time consuming process: It took two years for the State, local government, industry and interested parties to agree on the final form of the legislation. In California, such structural reform may require Constitutional amendment in addition to legislation and administrative rules at the State Board of Equalization, the Franchise Tax Board and the Public Utilities Commission, among other agencies. Moreover, such reform cannot take place at the cost of important State policies such as safety (i.e.; 911 support) and universal service. But, the price of achieving such reform and creating a new paradigm for communications taxes In California may be well worth the results for citizens, businesses and the State and local tax base well into the future.

**From:** Bill Rosendahl [bill.rosendahl@adelphia.com]  
**Sent:** Thursday, April 24, 2003 4:14 PM  
**Subject:** The Game Plan

Here are my thoughts on this issue.  
Regards,  
Bill

Telecommunications and other utility taxes/fees. Establish single statewide utility taxes. Change the way delivery of TV service is taxed so cable and satellite are on a level playing field.

Proposal: Impose a statewide tax on Direct Broadcast Satellite ("DBS") service that approximates the tax and fee burden on cable television operators and subscribers.

Analysis based on guiding principals:

#### 1. Fairness

Currently, the DBS industry, with over 1.6 million California subscribers, has almost 20 percent of the multi-channel video market. DBS companies generate gross revenue of over \$1.5 billion in California. Neither DBS companies nor subscribers pay State or local taxes. By contrast direct competitors to DBS, Cable TV operators, and 8 million Californians who subscribe to cable pay over \$300 million in local taxes, utility fees and local franchise fees on revenues of \$3.8 billion. Cable companies pay an average of 8 percent of their revenues in franchise fees, property taxes and utility user taxes to local governments.

An 8 percent tax on the total gross of a DBS subscriber's monthly bill is an equitable solution to ensure that similarly situated taxpayers are taxed similarly. A tax on subscribers and collected by DBS operators through subscribers' bills would provide for transparency and visibility by delineating that the tax exists and how and when it is imposed upon them and others. Like currently existing sales and use taxes, it can be structured to minimize non-compliance. Most importantly, a tax on DBS provides competitive neutrality in an important area of the new economy by balancing the burdens between providers of multi-channel video service: tax differences would no longer play a role in a taxpayer's decision to choose cable or DBS.

#### 2. Simplicity

A tax on subscribers and collected by DBS operators through subscribers' bills at a set rate meets the principle of simplicity. It can be certain by clearly specifying on the bill when the tax is to be paid, how it is to be paid, and how the amount to be paid has been determined. A tax paid by a subscriber at the time of payment of a DBS bill will be at a time or in a manner that is most likely to be convenient for the taxpayer. It will also permit taxpayers to understand the rules, and comply with them correctly and in a cost-efficient manner. Collection by the DBS provider and remittance to the State will keep the costs to collect a tax to a minimum for both the government and taxpayers.

### 3. Efficiency

In terms of efficiency as defined by stable tax base and economic growth, a tax that equalizes that burden between cable and DBS will give the State a reliable revenue base: migration of customers to DBS will no longer result in decreased revenues because, even if local governments are losing tax and fee revenues, the State tax will neutralize any overall revenue reduction. A DBS tax will also promote economic growth by encouraging competition based on innovation and consumer satisfaction, not tax and fee differential.

#### Other considerations:

Recommendation of a DBS tax is consistent with the Commission's charge under Revenue and Taxation Code Section 38065. Under federal law, the State may, and local government is prohibited from, imposing a tax on DBS. (See section 602(c) of the Federal Telecommunications Act of 1996) California added Part 15 to the Revenue and Taxation Code many years ago to ensure tax parity between cable companies and other providers. However, that code has not been amended to keep pace with the DBS industry. Fourteen other states, including Florida and taxes, tax DBS service at rates ranging from 4 percent to 13.17 percent.

**From:** Bill Rosendahl [bill.rosendahl@adelphia.com]  
**Sent:** Friday, April 25, 2003 4:16 PM  
**Subject:** The Game Plan

Aside from my thoughts on the DBS issue, here are some more thoughts on a broader level regarding Telecommunications and other utility taxes/fees.

Regards,  
Bill

#### Proposal: Statewide Communications Simplification Tax

Description: Combine all State and local taxes, fees and surcharges charged on providers of electronic communications services (e.g.; telephone companies, cellular companies, cable television companies, satellite companies) and their customers into one statewide tax on customers' communications bills collected by the distributors and allocated by the State Board of Equalization to State and local jurisdictions currently receiving revenues from existing taxes, fees and surcharges on a revenue-neutral basis.

Critical New Economy Issue: Digital communications is at the heart of the New Economy. One important result is convergence: monopolies, legal or perceived, are falling: providers, which traditionally offered only one service, are now capable of offering multiple service subject to various tax and fee obligations; and, technology is rapidly offering a whole host of new alternatives to providers and consumers. Increasingly, the federal government, the State and local government regulation of providers and services is put at issue by deployment of new technologies to meet consumers' desires. Simply put, taxes, fees and surcharges on communications predate the internet-or the Internet tax freedom acts, and no one can reasonably predict future market choices consumers will make and the consequences for State and local taxes and fees. For example, will traditional telephone markets be altered significantly by cellular or IP telephone? Or, will WiFi technology displace landline broadband market share? Or, what will the impact of bundling of services by a single provider into a single rate when those services are subject to different taxes and fees at the State and local level? Old paradigm taxes, fees and surcharges on communications providers and consumers designed to meet the revenue needs of the State and its political subdivisions-including, but not limited to franchise fees, utility user taxes, property taxes, and CPUC telephone surcharges-are premised on monopolies offering discreet services with stable technology. They, therefore, cannot insulate the State's revenue base from technological change, competitive choice or regulatory flux, and call for consideration of structural reform.

Guiding Principals: Any wholesale change in communications taxes must achieve the goals of fairness, simplicity and efficiency. A single statewide tax in lieu of the multiple taxes currently imposed on communications can be fair, by ensuring that tax differences would no longer play a role in a consumer's decision to choose a provider or technology, and simple, by permitting taxpayers and providers which collect taxes to understand the

rules, and comply with them correctly and in a cost-efficient manner. A single tax system can be highly efficient by insulating State and local tax revenues, broadening the tax base, eliminating multiple tax filings, and giving providers the greatest flexibility to deploy technologies and services with certainty as to the burdens associated with such offerings. This will encourage investment in California infrastructure and customer choice.

Considerations: Consideration of a Communications Simplification tax is consistent with the Commission's charge under Revenue and Taxation Code Section 38065. Florida has already put such a tax in place. See, Communications Services Tax Simplification Law, Taxation and Finance Code, Title XIV, Chapter 202. As Florida experience demonstrates, structural reform is a time consuming process. It took two years for the State, local government, industry and interested parties to agree on the final form of the legislation. In California, such structural reform a time consuming process: It took two years for the State, local government, industry and interested parties to agree on the final form of the legislation. In California, such structural reform may require Constitutional amendment in addition to legislation and administrative rules at the State Board of Equalization, the Franchise Tax Board and the Public Utilities Commission, among other agencies. Moreover, such reform cannot take place at the cost of important State policies such as safety (i.e.; 911 support) and universal service. But, the price of achieving such reform and creating a new paradigm for communications taxes In California may be well worth the results for citizens, businesses and the State and local tax base well into the future.



## **Scott Peters – Proposal 1**

Proposal: Constitutional Protection of Existing Local Revenues

Proposal: Lower the two-thirds voter approval threshold currently applicable to local governments.

Everyone knows that Proposition 13 limited property tax revenues, but few citizens are aware that it also shifted power over those revenues from local governments to Sacramento. The separation of local responsibility for services from authority over the revenue needed to fund them has led to an unfair and unwise local tax policy. The state's allocation formula attempted to soften the blow of Prop 13 by freezing 1978 distribution levels. This unfairly rewarded high tax cities and penalized conservative cities.

State officials' responses to complaints from local governments about property tax spending shifts have generally been that local governments should be responsible for raising additional revenues locally. This has proven difficult. First, local officials are wary of asking for additional local property taxes in an environment when existing local revenues are at risk. Second, the two thirds vote threshold means that very little opposition is needed to defeat revenue initiatives. In recognition of this, the state recently lowered the threshold for approval of school bonds to 55%.

These proposals would provide a constitutional minimum allocation of property taxes to local governments and would empower local officials to raise money for infrastructure, public safety and other local public investments.

Analysis based on guiding principles:

### **Fairness**

Under the current system, the amount of property tax collected within a jurisdiction that is returned to that jurisdiction depends to a great extent on the level of government spending in that jurisdiction 25 years ago. Taxpayers in some cities receive ten percent of their money back; taxpayers in other cities receive 25 percent. The state government has all of the power to determine those percentages. However, voters assume that their property tax money is available to their local governments, and they hold local elected officials for local public safety and infrastructure funding. A constitutional minimum allocation of property taxes to local governments could redress the differential distributions of tax revenues and could prevent further shifts of local money from local governments.

### **Simplicity**

In addition to being fair, a consistent apportionment of property tax revenues to localities throughout the state would be simple and transparent.

### **Efficiency**

The current tax system prevents local governments from determining how much revenue will be available and when. That uncertainty interferes with local government's ability to

plan for investments that could support the productive capacity of the economy.

## **Scott Peters – Proposal 2**

The incentives for local government action are askew. Since cities cannot rely on sufficient or certain property tax revenue, they look to increase sales tax revenue. That sends cities scrambling to build Wal-Marts and Home Depots we don't really need instead of the housing we desperately do need. Under the current system, housing costs more for a city than the property tax the city can get back from Sacramento by approving it.

Proposal: Swap State Controlled Revenues for Property Tax Revenues.

### Fairness

It is senseless to treat potential investors in housing less favorably than similarly situated retail investors. The means of distributing sales tax, and local government reliance on those sales tax revenues, greatly affects the decisions of local government on land use matters.

### Efficiency

In the long run, the reliance on state controlled revenues does not provide an appropriate set of rewards and penalties for local government. The tax system is impeding the ability of the economy to produce housing at a time when housing costs are among the biggest challenges for businesses operating in California. Allowing local governments to keep a greater share of property tax revenues, perhaps in exchange for the state keeping an equivalent amount of sales tax or vehicle license fees, would reward the investments local governments make in increasing property values. It would also lessen the artificial impetus for promoting retail in lieu of other land uses, especially housing.

TO: Chairman Rosendahl and Commissioners  
California Commission on Tax Policy and the New Economy

FROM: Sunne Wright McPeak, Ex-Officio Commissioner  
California Economic Strategy Panel

DATE: May 22, 2003

RE: Comments and Recommendations for Interim Report

I regret that my schedule of prior commitments prevents me from attending the Commission meeting today in El Segundo. I have been following the proceedings and reported again on them to the California Economic Strategy Panel on May 8<sup>th</sup> in Sacramento. The following are comments and recommendations for your deliberations on the Interim Report. Thank you for your consideration.

- Include the “Pro-Economy Principles” for evaluating tax structure as recommended by the California Economic Strategy Panel in addition to the Standard Principles.
- Set forth the importance of “both sides of the revenue dynamic” as discussed in the Bay Area Council testimony from April 14th: (1) reasonableness of the tax source (according to the Standard and Pro-Economy Principles); and (2) appropriateness of designated use (regarding level of government to which the revenue flows and purpose of use): (a) accountability for use of revenues; (b) alignment of revenues and responsibilities; and (c) return on investment.
- Incorporate recommendations regarding approach and process to foster a “culture of accountability” in the budget process (as per the recommendations from the Bay Area Council and the Speaker’s Commission on State and Local Government Financing):

**A “culture of accountability” and an “ethic of customer service” must be infused throughout all of government so that taxpayers can better evaluate performance by their representatives. In fact, increased accountability will help taxpayers view government operations not just as expenditures, but rather as “investments” from which they can expect certain “dividends” that benefit them. A public spotlight on outcomes and performance may also foster a greater willingness by taxpayers to “invest” more for particular purposes based on expected results.**

- To improve accountability, require the state and all political subdivisions to prepare budgets which delineate measurable goals and objectives.
- To eliminate barriers and promote efficiency, require each county along with all political subdivisions within that county to periodically hold joint hearings (e.g., once every ten years) to determine the fewest number of separate taxing authorities and political subdivisions needed to efficiently and effectively achieve

the performance outcomes specified in the collective budgets. Such a plan could be required to be submitted to the voters for approval to increase individual responsibility and accountability. This approach to efficiency is complementary to the concept of a “Community Charter” (as recommended by the Constitution Revision Commission) and ensures that the citizenry has an opportunity to regularly review and engage in the design and structure of government.

- Endorse at least the following components of tax policy:
  - Swapping local property tax revenues designated by the state for schools (ERAF – sometimes referred to as a “state tax”) for ½ cent of local sales tax that would then flow to the state. This was recommended by the Speaker’s Commission on State and Local Government Financing.
  - Provide Constitutional protection for local general purpose government revenues.
  - Lower the voter threshold for voter-approved local bond measures for purposes other than education bond measures (which is now at 55%). The Commission should recommend consideration of the “flip” of 2/3 approval now required for “special purpose” tax revenue measures be applied to “general purpose” measures and the simple-majority now required for general purpose now be applied to special purpose (because the voters and taxpayers by definition have more say and control over special purpose revenue measures, therefore the vote threshold should be lower).
  - Consider periodic reassessment of non-residential property, provided it is structured to align revenue and responsibility in an innovative approach that will result on the highest-possible return on investment. The following are the essential components of a potentially-workable approach to this concept: (a) State authorizes local government through each County Board of Supervisors to establish an Infrastructure Investment Fund (perhaps also could be used for affordable housing) that is capitalized by a periodic reassessment of non-residential property, provided it is also endorsed by a majority of the cities representing a majority of the population in the county; (b) Periodic reassessment is done on a cycle that is the average of residential property turn-over in the state (perhaps determined by the State Board of Equalization every decade); (c) An Infrastructure Investment Commission (or some other appropriate name) of reasonable size (such as at least 15 member) is appointed to advise on the investment and expenditure of funds in the Infrastructure Investment Fund, with a majority of the members representing owners of non-residential property who also reside in the county; (d) Infrastructure Investment Commission must first develop an Infrastructure Investment Plan that is approved by the County Board of Supervisors and a majority of cities representing a majority of the population before any new non-residential assessments can be levied; and (e) Infrastructure Investment Plan must be updated periodically (say no less frequently than every 5 years).
- Consideration of a single statewide telecommunications tax should be coupled with a dedication to statewide infrastructure, including accelerating the deployment of

broadband (an approach which aligns revenue, responsibility and return on investment).

- Support reinstatement of the high-level Vehicle License Fees for local government (which already are Constitutionally protected as a local revenue, but need further protection regarding the mechanism for changing them in the future).
- Consider reinstatement of the higher-level income brackets dedicated to the State General Fund (particularly to support education and sustain reforms that have been enacted and are showing promise) as an immediate action. This also could be a transition to a flat tax if the Commission thinks that concept or a VAT has enough merit.
- Embrace the recommendations in the reports from the California Economic Strategy Panel, Speaker's Commission on State and Local Government Financing, Speaker's Commission on Regionalism, and Commission on Building for the 21st Century as a sound foundation on which to consider tax policy for the 21<sup>st</sup> Century.

## PROPOSAL FOR THE CALIFORNIA COMMISSION ON TAX POLICY FOR THE NEW ECONOMY

California should establish a tax court to resolve all tax disputes, including personal income tax, corporate income tax, sales and use tax, all property taxes, all payroll taxes and all excise taxes.

The current system for both the administrative and judicial resolution of tax disputes in California does not provide a fair, reliable, or efficient means of resolving tax disputes, especially in comparison to the procedures available to resolve federal tax disputes. The problems with the current system include the following:

- The highest forum to which most taxpayers can pursue their tax appeals without payment of tax, interest, and penalty is the State Board of Equalization. Board members serve for limited terms and are not trained specialists in tax law.
- With certain limited exceptions, an administrative resolution of disputes does not take into account the “hazards of litigation”. This factor, when objectively applied by independent tax resolution specialists, encourages the settlement of tax disputes. Instead, for many taxes, California maintains an all or nothing policy thereby forcing taxpayers to concede the entire amount in dispute or pursue litigation.
- There is no practical judicial alternative to dispute resolution. In the federal system, taxpayers who are unable to settle with the Internal Revenue Service are afforded the opportunity to present their case to the United States Tax Court without paying any tax, interest, or penalty. In contrast, the resolution of most tax disputes in California in Superior Court requires the payment of tax, interest, and penalty in full before the Court can have jurisdiction. As a practical matter, this requirement deprives most California taxpayers of any judicial resolution. Additionally, the judges of the United States Tax Court are trained and experienced in tax law. In contrast, virtually all Superior Court judges have no particular tax expertise. Finally, the publication of decisions by the United States Tax Court provides a growing body of judicial precedent that can serve as guidance to all taxpayers. In contrast, California has a very limited number of published decisions on tax disputes.

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## PROPOSAL FOR THE CALIFORNIA COMMISSION ON TAX POLICY FOR THE NEW ECONOMY

The establishment of a state tax court would satisfy the main principles of tax equity as described below:

1. Fairness. By offering a prepayment judicial forum, the state tax court would provide an opportunity to many California taxpayers who do not have the

opportunity to obtain a judicial resolution of their tax disputes. Additionally, the independence of the state tax court from the taxing agencies will increase the perception of fairness from both taxpayers and their representatives.

2. **Simplicity.** A state tax court improves compliance with the tax law and the collection of taxes by making dispute resolution fairer and simpler. Also, the development of a consistent body of judicial precedent will provide guidance to taxpayers to comply.
3. **Efficiency/Balance.** A prompt resolution of tax disputes by an independent court will provide appropriate incentives to both taxpayers and government agencies to resolve tax disputes.



CALIFORNIA



SPACE  
AUTHORITY

December 16, 2002

The Honorable William Rosendahl  
Chairman  
California Commission on Tax Policy in the New Economy  
1102 Q Street, 6000  
Sacramento, CA 95814

Dear Chairman Rosendahl:

This letter is in response to the Interim Report of the California Commission on Tax Policy in the New Economy. Page 20 discusses Telecommunications Taxes and makes commentary that because satellite television subscribers do not pay cable utility user taxes nor cable franchise fee taxes imposed by local governments there is an inequity which might influence customers to migrate from cable use to satellite use, thereby reducing revenues to local governments. The California Space Authority appreciates this opportunity to show why these two television provider mechanisms are different and why the taxing structure that exists cannot be equated.

Cable customers pay a 5% franchise fee that is passed on to them by the cable companies. This fee is paid to local governments much like a business license fee. It is really a fee paid to the city to be the exclusive provider. Since satellite television services do not monopolize a community, there is no need for local governments to establish such contracts with the satellite television service providers. Accordingly, federal law precludes local governments from charging such a franchise fee against satellite service providers and their customers. But just as with any business, any vendor who sets up a retail shop in any town for the purposes of selling satellite television systems is required to pay that community a local business-license fee. Sales taxes are also collected for the sale of any equipment purchased for satellite television use, unlike cable boxes that are merely rented by the cable consumer.

Cable customers also pay a utility users tax. This figure varies by local government but ranges from 5% to 13%. This is a tax imposed by the local government against all privately operated utility providers. It is paid to local governments for the privilege of cutting up the streets now and then when service is needed on the various utilities that are in the streets. Satellite television service avoids this need by using newer and more modern technology than cable. Instead of wires, satellite television service uses a completely different delivery system that does not impose any impact whatsoever on city streets. Like radio transmissions, which are not taxed at the state level, satellite television sends its signal via the air.

Debate in the Legislature has already occurred on this issue with the cable industry unsuccessfully arguing for a new state sales tax to be imposed only on satellite television services. They have argued, just as they have stated in hearings with this Commission, that such a tax on satellite service would equate the taxes and fees they and their customers pay to local governments. For the arguments stated above, we respectfully disagree.

Sincerely,

Eric A. Daniels  
Director, State and Local Governmental Relations

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## **Testimony of Mike Palkovic at Meeting of the California Commission on Tax Policy in the New Economy**

May 22, 2003

Mr. Chairman, members of the Commission. Thank you for the opportunity to address you today.

My name is Michael Palkovic, and I am Senior Vice President and Chief Financial Officer for DIRECTV, headquartered here in the city of El Segundo.

DIRECTV is the largest Direct Broadcast Satellite (DBS) provider in the United States, with more than 11 million subscribers.

Television in California – or America for that matter – is not a luxury that cries out to be taxed. It is the principal medium for information, entertainment and education in most households, regardless of their income level.

And where TV once came into the home for free, most Americans have voted with their pocketbooks for pay TV because of the vastly expanded content, service and quality that it provides.

Today, over 100 million U.S. homes subscribe to pay TV - whether delivered by cable, satellite or microwave. And even in hard times, one of the last things citizens are willing to sacrifice, is their access to this vital and growing medium.

To increase the monthly TV cost for Californians is unwarranted and unreasonable. TV makes no demands on the state that justifies a tax.

In the case of cable, a fee is charged by local governments to compensate for any use of the city's infrastructure. In the case of satellites, fees are charged by the federal government -- and, of course, satellite TV has no impact on either state or local infrastructure.

While we oppose any TV tax, if our argument falls on deaf ears in Sacramento,

and the Legislature deems it necessary to tax pay TV subscribers, then it must in fairness tax all segments of this business

- regardless of the method citizens choose to deliver essentially the same service.

The only reason the State of California is seeking additional revenue sources is its huge deficit. It makes no sense, therefore, for the state to tax one fourth of a class - and exempt the other three quarters.

According to SkyTrends, a leading industry research authority, there are some 2.2 million satellite TV subscribers in California compared with 7.4 million cable TV customers. Let's assume that each DBS or cable customer spends \$50 a month. A 5% tax on DBS alone would yield \$66 million a year in taxes. But a 5% tax on both satellite and cable subscribers would yield a whopping \$288 million a year.

As I said before, I am opposed to any kind of service tax on subscription TV. But if our state is so desperate that it feels it must tax Pay TV viewers, then it must tax all segments - cable, satellite and microwave. Fairness demands this, and so does the Constitution of the United States.

It is absurd for cable operators to demand an exemption from a state sales tax on the grounds that they pay franchise fees to local municipalities, and I urge the State to discard this fallacious claim.

Federal, state and local authorities have said repeatedly that a fee is a fee and a tax is a tax, but for the record let me say it again: a fee is a payment for a privilege. You pay the state a fee, and they give you a driver's license. You pay a city a fee, and they give you a cable franchise. We pay the FCC a fee, and they give us an orbital parking place for our satellites.

In contrast, a tax is a levy that pays for the expenses of government.

We will continue to strenuously resist the efforts of the cable industry to saddle us with unjust taxes in order to improve their competitive position in the marketplace.

Finally, I must record our dismay at the Chairman's conflict of interest.

He is not only chairman of this commission, he is also a senior executive with Adelphia, a large cable company and the president of the California Cable &

Telecommunications Association.

CCTA has been engaged in a political lobbying effort in Sacramento since the fall of last year. First, CCTA sought to gain a marketing advantage by saddling Satellite TV subscribers with a 5% service tax, while exempting Cable TV service. When that was defeated, they came back this year with an even bigger tax idea - 8%!

We were shocked when we were recently given a copy of an e-mail from Chairman Rosendahl, sent from his Adelphia e-mail account, to the staff of this commission - with copies to fellow commissioners and members of the legislature - that faithfully echoes the political propaganda that his Cable Association has been distributing in Sacramento.

Despite repeated requests to be allowed to appear before this Commission, my industry was not given this opportunity until today, when the report is a hair away from being finalized.

I note that the content of the Final Report is to be discussed at 3:30

p.m. I trust that this will include the perspective of the satellite television industry, and not just that of the cable TV industry.

Thank you.



Communications Corporation

Testimony of Michael McDonnell,  
Senior Vice President and Chief Financial Officer,  
EchoStar Communications Corporation,  
Before the Governor's Commission on Tax Policy in the New Economy  
May 22, 2003

Chairman and members of the Governor's Commission on Tax Policy in the New Economy, I am honored to be asked to appear before you today and appreciate the opportunity to represent my company's views on an issue important to California consumers and businesses. I know this Commission is working very hard to solve difficult issues with sound public policy for this state and its citizens. My name is Michael McDonnell, and I am Senior Vice President and Chief Financial Officer of EchoStar Communications Corporation.

EchoStar Communications Corporation, through its DISH Network, is a leading U.S. provider of satellite television entertainment services with 8.53 million customers. DISH Network provides advanced digital satellite television services to the home, including hundreds of video and audio channels, personal video recording, HDTV, sports and international programming, professional installation and 24-hour customer service. The DISH Network offers consumers the lowest all-digital TV package price in America at only \$24.99 per month for more than 50 popular TV channels.

A growing number of Californians are subscribing to satellite television service. Roughly 2,200,000 California households get their pay television service from satellite – that's approximately 16.5 percent of the state's population.<sup>1</sup> Our company is committed to California. We allocate a portion of our limited bandwidth to provide local broadcast channels in 7 television markets: Los Angeles, San Francisco-Oakland-San Jose, Sacramento-Stockton-Modesto, San Diego, Fresno, Monterey, and Chico & Redding. . Furthermore, there are more than 750 EchoStar employees working throughout the State. We have major sales distribution centers in Sacramento and Torrance. Lastly, from mom-and-pop dish dealers to national retailers like Radio Shack and Sears, more than 2,000 retailers sell our service statewide.

I traveled here today to provide our perspective on the proposal to tax satellite-delivered television service. We feel strongly that, based upon the facts, the Commission will conclude that there is no justification for a satellite TV tax. We understand this Commission's charge to examine the impact of Internet and other forms of electronic technology on various types of taxes including telecommunication taxes and fees.

However, we feel imposing a tax only on satellite TV is an unfair, unwise and unsound tax policy for California.

Around the country, and now in California, cable operators complain that cable television is unfairly taxed, and that this satellite tax would “level the playing field” and achieve “tax parity.” We strongly disagree with this assertion. Far from “leveling the playing field”, the proposed satellite tax would unfairly charge satellite customers a fee for costs only applicable to cable service. It would end up giving the dominant cable operators another competitive advantage in the market and encourage further rate hikes on their customers. It would impose a disproportionate and unfair burden on rural

<sup>1</sup> DTH subscription counts, as of April 1, 2003, are an aggregate total of DIRECTV, ECHOSTAR, and C-Band subscriptions. DTH subscription counts are provided by Sky Research.

Californians. For these reasons, we oppose any proposal to exclusively tax satellite television service.

**The satellite tax unfairly charges satellite customers for costs only applicable to cable service.**

Despite the claims by cable providers, a state satellite tax is not equivalent to the local franchise fees paid by cable. Franchise fees grant cable companies the right to use public infrastructure, and underwrite the administrative costs of the franchise authority. In essence, the cable operators are paying for the rights to tear up streets and sidewalks, and for the continuous use of these rights of way as they do business. These fees are a discrete and unique part of cable’s cost of doing business.

The courts and the Federal Communications Commission (FCC) already reached this conclusion. In *Dallas v. FCC*, the courts held that franchise fees are not a tax but more like a form of rent. An advisory committee to the FCC put it this way: “Franchise fees are the rent cable operators pay for the use of public rights of way.” Similarly, the Financial Accounting Board’s Statement of Financial Accounting Standards No. 51 affirmed for the court that “cable franchise fees are costs no different than the General Managers salary, marketing costs and programming costs.”

Satellite companies do not require the use of state or local infrastructure because we do not deliver our service in the same way as cable. Customers receive our service over-the-air from satellites orbiting the Earth. There are no public rights of way required, and no administrative costs for franchise authorities.

Satellite companies do pay taxes and fees to the government. Our company is subject to the same California sales taxes on property, income and equipment as cable. However there are some fees that are exclusive to satellite. Satellite companies pay annual regulatory fees to the FCC for our licenses. Similar to the cable franchise fees, these costs are specific to satellite service because cable operators do not use satellite spectrum in providing their service. Additionally, EchoStar paid enormous costs on the order of \$700 million to get access to its satellite spectrum.

### **The satellite tax gives cable a competitive advantage.**

The imposition of a satellite tax is not in the best interest of California consumers. Cable providers dominate the pay television market and already enjoy significant competitive advantages over satellite. The imposition of a satellite tax would create another one. It would also encourage cable operators to raise their rates because cable would now have less price competition from satellite TV.

While satellite service has become a viable alternative to cable in the pay television market, cable providers in California still account for more than 55 percent of all pay television households totaling more than 7,400,000 households.<sup>2</sup> And yet, on a national basis cable rates are still up 50% since 1996, increasing nearly three times the rate of inflation.<sup>3</sup> The truth is that cable's alleged competitive disadvantage does not exist in the real world.

<sup>2</sup> Id.

<sup>3</sup> Bureau of Labor Statistics, Consumer Price Index (March 2003). From 1996 until March 2003, CPI increased 19.3% while cable prices rose 50.3%, 2.6 times faster than inflation.

Our company's inability to provide local channels via satellite in many California television markets is one example of the many cable advantages over satellite. Due to capacity constraints, the DISH Network only offers local broadcast signals in 65 large television markets across the country like Los Angeles and San Francisco. In these markets, our company can compete with cable providers, because we can offer consumers a similar plate of services. However, in the remaining 145 of 210 small and medium sized television markets, like Santa Barbara-Santa Maria-San Luis Obispo (#119), Bakersfield (#130), Palm Springs (#161), Yuma, AZ-El Centro, CA (#172), Eureka (#190), our company cannot effectively compete because we cannot provide local broadcast channels like cable. Our research has found that consumers do not consider satellite television without local service a viable alternative to cable. The inability to offer local broadcast channels is a challenge our company faces in the market, and one that we're trying to solve through technological innovation and marketplace solutions.

The imposition of a satellite tax would not "level the playing field," but would give the dominant cable providers another competitive advantage in the market. It would also encourage them to continue raising their rates on cable subscribers. On behalf of both satellite and cable customers, we believe the satellite tax is bad policy for the state.

### **The state satellite tax discriminates against the state's rural consumers.**

The satellite tax is particularly unfair to consumers living in California's rural areas. Consumers living in these areas often have fewer choices for basic services. It's no exception in the pay television industry. Local cable companies do not offer service in some rural areas. Instead they invest their money in more profitable regions of the state. Thus in these unserved cable areas, DISH Network and DIRECTV are the only viable options. Therefore should the state impose a state satellite tax, rural Californians would have no choice but to bear the burden of higher satellite subscription fees. Even if you

agree that a tax on satellite results in “tax parity” among cable and satellite services, you can’t deny that rural consumers without a cable alternative would still be treated unfairly. For these consumers, the satellite tax is particularly discriminatory.

Nearly half the funds collected from this proposed tax would come from Californians living in the state’s rural areas. Our latest demographic information shows that forty-seven (47) percent of all satellite television subscribers live in these areas.<sup>5</sup> The other subscribers are split between suburban and urban areas. The satellite tax would be solving the state’s problems by taxing rural Californians.

**If the Commission recommends a satellite tax, then it should recommend an equal tax on cable.**

The DISH Network prides itself on being the low cost provider of pay television service in the market. On behalf of our subscribers, our company opposes any tax increase that will raise the cost of our subscriber’s service. Recognizing the state’s need to address its budget shortfall, we strongly believe that should the commission recommend a state satellite tax, the Commission should also recommend an equal tax on all providers of pay television service in the state. Please keep in mind that should the legislature pass a satellite-only tax, California would join North Carolina, as the only

<sup>5</sup> 2003 Market research performed by the Taylor Group on behalf of the Satellite Broadcasting and Communications Association.

other state to impose a tax of this kind. We believe there are constitutional issues in the discriminatory tax treatment of one segment of one industry, and we intend to challenge any taxes that are imposed upon our customers in a discriminatory manner.

**Conflict of Interest**

In the last few days, we have learned about a conflict of interest within this Commission. Although we respect the Commission’s mission and its responsibility to the Governor and the State Legislature, we hope your ultimate recommendation is based solely upon the merits of tax policy. We feel strongly that once all facts are considered, the Commission will agree that a satellite-only tax is not justified. To ensure the public’s confidence in this Commission and those who have testified before you, we respectfully request the Commission to provide the state’s elected leaders – those who will be charged with solving California’s budget crisis – with clarification of this conflict of interest in your final report. In the spirit of fairness to all Californians, we believe it’s the only appropriate thing to do.

**Conclusion**

The ramifications of imposing a satellite TV tax are overwhelmingly negative for California consumers and businesses. The satellite tax unfairly seeks to charge satellite customers a fee for costs specific to cable companies. It would also give the dominant cable companies another competitive advantage in the market and encourage further rate increases. Lastly, the satellite tax imposes an unfair burden on rural Californians. For all of these reasons, we think the satellite tax is unfair to California consumers and



businesses.

Thank you very much for your time and for providing EchoStar, the opportunity to provide our perspective on this important issue.



Governor Gray Davis      July 14, 2003 State Capitol Building Sacramento, CA 95814

**RE: "Options for Revising the California Tax System."**

Dear Governor Davis,

On behalf of California's Direct Broadcast Satellite (DBS) providers, we would like to bring to your attention several errors and omissions in the report sent to you on June 15 by the Chairman of the California Commission on Tax Policy in the New Economy.

Executives from DIRECTV and EchoStar Communications' DISH Network appeared before the Commission on May 21, and argued -- in both written and oral testimony -- that a tax on satellite TV and not cable TV service would be unfair. We urged the Chairman to include our views in his report to you, and are disappointed that this did not occur. The latest report remains flawed and heavily biased in favor of the cable industry.

**The report understates the number of DBS subscribers in California**

In Section 6 (Direct Broadcast Satellite Tax) the paragraph headed "Background" states that there are 1.6 million California DBS subscribers. The correct number, as of April 1 and growing daily, is 2,235,357. According to the U.S. Census Bureau there are 2.58 viewers per household, which means *that nearly six million Californians* have switched to DBS.

**The report does not draw a crucial distinction between those states taxing cable and satellite the same, and those states taxing satellite TV in a discriminatory fashion.**

The report says 14 other states, including Florida and Texas, tax DBS services at rates ranging from four to 13.17 percent. The truth is that 19 states and the District of Columbia apply state sales taxes equally to satellite and cable TV. (The 19 states are

Arkansas, Connecticut, Hawaii, Indiana, Iowa, Kansas, Maryland, Minnesota, Mississippi, Nebraska, New Mexico, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, West Virginia and Wisconsin.)

Only two states -- Ohio and North Carolina -- tax DBS customers but not cable viewers - and we have initiated legal action in both of these states, challenging the constitutionality of their discriminatory tax laws. Tennessee and Florida tax both satellite and cable TV, but provide more favorable tax treatment to cable TV, and we are reviewing our legal options in these states.

**The report fails to provide the most salient points against the proposed tax in its pros-and-cons chart.**

In our testimony, we provided many compelling reasons for not imposing the proposed DBS tax. These arguments did not appear in the new report.

- . • A tax on DBS and not cable is unconstitutional, and that imposing a discriminatory tax of this kind will lead to legal action against the State. This “con” was ignored.
- . • A DBS tax unfairly discriminates against Californians who live in rural areas not served by cable. This “con” was ignored.
- . • A tax on DBS service would encourage cable to continue their annual rate increases, to the detriment of consumers. This “con” was ignored.
- . • We explained the difference between fees and taxes, and cited eminent authorities, including federal and state courts, government agencies and consumer advocates, who affirm that payment of local franchise fees is an exchange of money for right-of-way and other privileges, and that payment of these fees cannot be used as an excuse to evade state taxes. We pointed out that cable franchise fees are a normal cost of doing business, no different from the fees DBS providers pay to the Federal government. This “con” was ignored.
- . • We spoke of the substantial investments the DBS industry has made in new technologies that bring digital entertainment and information to all Americans at a more affordable cost, and the unfairness of burdening with punitive taxes the almost six million Californians who have chosen to switch to DBS. This “con” was ignored.

The Chairman, in his letter to you, wrote that “we are here to serve you and all Californians.” Reading his report, we believe he has disenfranchised nearly six million Californians.

We respectfully request that you remind the Commission that its mandate is to develop sound, long-term tax policy solutions, and not to focus on giving one provider in an industry a specific, competitive advantage over another.

To fully serve its purpose, the Commission's report should not be open to challenges for being biased or unfair. To that end, we ask that you instruct the Commission to fully consider offering all points of view on this issue, rather than a carefully redacted list designed to favor the special interests of the cable industry.

We are available for further testimony, and would appreciate being invited to continue our dialog with the Commission.

<b>Roxanne S. Austin</b> President and Chief Operating Officer	<b>Charles W. Ergen</b> Chairman and Chief Executive Officer EchoStar Communications Corporation
---	---



**Michael J. Gallo Bob Phillips**

Chairman President and Chief Executive Officer President  
California Space Authority National Rural Telecommunications  
Satellite Broadcasting and Cooperative Communications

**Andrew  
Wright**

Association



**CSA: Memo in Opposition to Section 17 of SB 1849**

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December 16, 2002**

**The Honorable William Rosendahl  
Chairman  
California Commission on Tax Policy in the New Economy  
1102 Q Street, 6000  
Sacramento, CA 95814**

**Dear Chairman Rosendahl:**

**This letter is in response to the Interim Report of the California Commission on Tax Policy in the New Economy. Page 20 discusses Telecommunications Taxes and makes commentary that because satellite television subscribers do not pay cable utility user taxes nor cable franchise fee taxes imposed by local governments there is an inequity which might influence customers to migrate from cable use to satellite use, thereby reducing revenues to local governments. The California Space Authority appreciates this opportunity to show why these two television provider mechanisms are different and why the taxing structure that exists cannot be equated.**

**Cable customers pay a 5% franchise fee that is passed on to them by the cable companies. This fee is paid to local governments much like a business license fee. It is really a fee paid to the city to be the exclusive provider. Since satellite television services do not monopolize a community, there is no need for local governments to establish such contracts with the satellite television service providers. Accordingly, federal law precludes local governments from charging such a franchise fee against satellite service providers and their customers. But just as with any business, any vendor who sets up a retail shop in any town for the**

**purposes of selling satellite television systems is required to pay that community a local business-license fee. Sales taxes are also collected for the sale of any equipment purchased for satellite television use, unlike cable boxes that are merely rented by the cable consumer.**

**Cable customers also pay a utility users tax. This figure varies by local government but ranges from 5% to 13%. This is a tax imposed by the local government against all privately operated utility providers. It is paid to local governments for the privilege of cutting up the streets now and then when service is needed on the various utilities that are in the streets. Satellite television service avoids this need by using newer and more modern technology than cable. Instead of wires, satellite television service uses a completely different delivery system that does not impose any impact whatsoever on city streets. Like radio transmissions, which are not taxed at the state level, satellite television sends its signal via the air.**


**Debate in the Legislature has already occurred on this issue with the cable industry unsuccessfully arguing for a new state sales tax to be imposed only on satellite television services. They have argued, just as they have stated in hearings with this Commission, that such a tax on satellite service would equate the taxes and fees they and their customers pay to local governments. For the arguments stated above, we respectfully disagree.**

**Sincerely,**

**Eric A. Daniels  
Director, State and Local Governmental Relations**

**[Return to the Satellite Tax issue]  
[Return to the Legislative page]  
[Back to the top]**

Slide 1



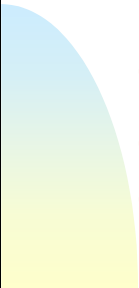
# The Taxation of Telecommunications in California

A Study by the Center for State and Local Taxation, UC Davis

Funded by a Grant From the California Policy Research Center

James E. Prieger   Annette Nellen   Terri A. Sexton

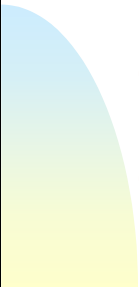
Slide 2



## Key Questions

- Is the burden of the existing tax treatment of telecommunications services and providers distributed equitably?
- Does the existing tax system impose different tax burdens on the providers (or consumers) of similar services?
- Is the existing tax structure the most efficient means of raising the current level of tax revenue?


Slide 3



## Key Questions

- Does the existing tax system distort the consumer's choice between competing telecommunications services and technologies?
- Does the existing tax system distort the location decision of telecommunications providers or consumers?


## Slide 4



### The Taxation of Telecommunications in California

- The telecommunications industry: deregulation and technological change
- Relevant federal laws and restrictions
- Corporate franchise and income taxes, sales and use tax, franchise fees, utility user tax
- Property tax, surcharges and fees, federal taxes
- Cumulative tax rate on telecommunications services
- Equity and efficiency consequences of existing tax policy
- Comparison to other states
- Key questions and recommendations


## Slide 5



### Importance of Telecommunications

- Direct contribution to GSP: \$38B in 1999 (3.4% of whole)
- Growing over time
- Raises productivity of other sectors
- Growth in telecom infrastructure caused 17 percent of the per capita GDP growth 1971-1990

## Slide 6



### Recent History of Telecom Industry

- Breakup of AT&T in 1984: opened long distance market
- Telecom Act of 1996 (TA96): opened local market (theoretically)
- TA96 enables entry by resellers and facilities-based competitors
- Progression from a stable, technologically unified environment to a dynamic, technologically diverse milieu.



## Slide 7

### Technological Convergence

- Competitive Local Exchange Carriers
- Cross-Market Entry (e.g. IXC into local)
- Wireless Communications Services
- Cable Telephony
- Internet Telephony
- Conversion of Private Networks (e.g. power utilities) and Self Supply
- It isn't the *technology* that matters, it is the *service*.

## Slide 8

### Technology Convergence Yet Tax Divergence?

**Example: Cable and telco**

- Cable companies are locally assessed, pay franchise fees, and have a taxable *possessory interest* in rights of way.
- Telcos are state assessed, do not pay franchise fees, and do not have a taxable possessory interest.
- BUT:**
  - Cable companies can offer telephony
  - Telcos can offer multichannel video programming (OVS)

## Slide 9

### Example: Internet Telephony

The diagram shows three paths to 'THE INTERNET' (represented by a cloud icon):

- 1. Analog Origination Equipment and a Gateway Operator:** A 'Net Phone' icon connects to a 'local wireline loop', which connects to 'Local Telco's Central Office', which then connects to a 'Gateway Operator' box, finally reaching 'THE INTERNET'.
- 2. Digital Origination Equipment over Wireline Network:** A 'Net Phone' icon connects to 'dialup Internet or DSL over local wireline loop', which connects to 'Local Telco's Central Office', finally reaching 'THE INTERNET'.
- 3. Digital Origination Equipment and Cable Modem Service:** A 'Net Phone' icon connects to 'cable modem service over cable network', which connects to a 'Regional Cable Headend' box, finally reaching 'THE INTERNET'.

May escape some or all taxes, fees and charges.

## Slide 10

### Federal Laws & Restrictions

- U.S. Constitution
  - ◆ Nexus - Due Process & Commerce Clauses
- Legislative Restrictions
  - ◆ P.L. 86-272 (1959) - income taxes on sales of tangible personal property
  - ◆ Telecom Act of 1996
    - Locals - no tax or fee on DBS service
    - Taxes and fees can't be barriers to entry for inter and intrastate telecom services; must instead tie to preservation and advancement of universal service, protection of public safety/welfare, quality, consumer rights and mgmt of public rights-of-way

## Slide 11

### Federal Laws & Restrictions 2

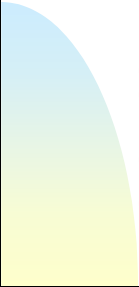
- Internet Tax Freedom Act
  - ◆ Internet access service doesn't include telecom services
  - ◆ Comm'n: Each state should only impose 1 state transaction tax on telecom and file only 1 tax return per state
    - What would happen to local's UUT revenues?
- Mobile Telecom Sourcing Act (2000)
  - ◆ uniform sourcing for mobile calls
  - ◆ remaining issues
    - differing rates and bases in over 150 CA cities/counties

## Slide 12

### Federal Laws & Restrictions 3

- Relevance of federal restrictions:
  - ◆ limits state and local actions
  - ◆ is CA providing sufficient input to Congress?

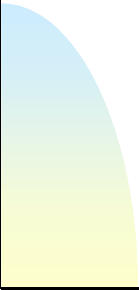
## Slide 13



### Corporate Franchise/Income Tax

- P.L. 86-272 is out of date
- Should intangibles (such as licenses) be included in the property factor?
- Are new rules needed for sourcing service income?
- [Should 1997 project on apportionment regs for telecom be renewed?]

## Slide 14



### Sales & Use Tax

- Should MIC apply to equipment purchases of telecom service providers?
- Could (should) a sales tax on telecom services replace existing taxes and fees?

## Slide 15



### Franchise Fees

- Does free franchise for telephone companies lead to effective mgmt of public rights-of-way today? Is this logical given merger of technologies and industries?
- Possible loss of franchise fees on cable modem creates problems for cities.

## Slide 16

### Utility User Tax

- Mobile Telecommunications Sourcing Act provides for uniform sourcing, but we still have differing tax bases, rates and reporting requirements among 150+ cities and counties in CA
- Telecom definition (IRC 4251) may be too narrow today
- Prop 62 and 218 limit local jdx's control over UUT revenue
- Regressive

## Slide 17

### Property Tax

- State versus local assessment
- Significance of intangible assets
- Rapid depreciation of tangible personal property
- Possessory interests
- Declining revenue stream

## Slide 18

### State Taxes on Intrastate Services

TAX	CURRENT RATE
<b>Universal Service</b>	
California Relay Service and Communications Device Fund (CRSODF)	0.48%
Universal Lifeline Telephone Service Program (ULLTS)	1.46%
California High Cost Fund A (CHCF-A)	0.36%
California High Cost Fund B (CHCF-B)	1.42%
California Teleconnect Fund (CTF)	0.30%
<b>California Emergency Telephone Users (911) Tax</b>	0.72%
<b>CPUC Regulatory Fee</b>	0.11%
<b>TOTAL</b>	<b>4.83%</b>

Slide 19

### Federal Taxes

TAX	CURRENT RATE
Federal Excise Tax (intra and interstate services)	3.00%
Federal Universal Service (interstate and international services)	7.28%

Slide 20

### Cumulative Tax Rate

Intrastate Services		Interstate Services	
State	4.83%	Federal Excise Tax	3.00%
Federal	3.00%	Fed. Univ. Service	7.28%
Local	0-11.00%	Local	0-11.00%
<b>TOTAL</b>	<b>7.83 - 18.83%</b>		<b>10.28 - 21.28%</b>

Slide 21

### Social and Economic Consequences of Existing Policy

- Theories of Equity :**
  - Benefit principle:** tax burden should match benefits. Violated by FET, UUT.
  - Ability to pay principle:** tax burden should match ability to pay. Violated by nearly all telecom taxes and fees (regressive).
  - Horizontal equity**
  - Equity between firms and consumers:** hard to define.
    - Legal incidence of tax ? economic incidence

## Slide 22

### Efficiency of Current Tax System

- Administrative simplicity is desirable.
  - ◆ Administrative costs are pure economic losses.
- Is the telecom tax system simple?
  - ◆ No! A full service telco has to file 8 times as many tax returns (nationwide) as other businesses.

## Slide 23

### Static Efficiency Losses

- Telecom revenue taxes in California leads to **losses in consumer welfare** (beyond the tax revenue collected)
  - ◆ Known as *excess burden* of a tax
  - ◆ Our estimates range from \$15M to \$100M annually, depending on taxes included.
  - ◆ Loss: up to 4% of tax revenue collected.
  - ◆ This is conservative: does not include losses in producer surplus.

## Slide 24

### Improving Efficiency

#### Rebalancing the tax rates

- When demand is more price sensitive, excess burden is greater.
- Price sensitive services should be taxed at lower rates than price insensitive services.
- Taxes on basic local service are best.
- Rebalancing the tax rates on local, long distance, and wireless calling can **reduce excess burden by 75-86%** with no loss in tax revenue.

## Slide 25

### Improving Efficiency

#### Expanding the tax base

- ◆ Excess burden increases with the square of the tax rate. Therefore,
- ◆ Larger tax bases with lower tax rates reduce excess burden
- ◆ Could expand tax base:
  - Include interstate telecom service revenue
  - Include all sales-taxable revenue
- ◆ Does not necessarily improve efficiency, because these other revenues are already taxed.

## Slide 26

### Dynamic Efficiency

- ◆ Static inefficiencies may be small in comparison with inefficiencies caused by distorted investment incentives.
- ◆ Dynamic productive efficiency requires that the social rates of return be equalized across assets.
- ◆ When taxes distort rates of return on assets, can introduce dynamic inefficiency.
- ◆ E.g.: MIC, unequal taxation of different providers.

## Slide 27

### Unequal Tax Treatment of Telephony

Market and Type of Firm	Property Tax	Reg Fees	Franchise fees	UIT	Federal USF	FET
<b>Local Service Providers</b>						
Telcos	state	Y	N	Y	Y	Y
Cable telephony	local	Y	N	Y	Y	Y
Long Distance Service Providers	state	Y	N	Y	Y	Y
Payphone Service Providers	state	N	N	N	Y	Y
<b>Mobile Service Providers</b>						
Cellular and PCS	state	Y	N	Y	Y	Y
mobile satellite	state	Y	N	N	Y	Y
<b>Internet Telephony</b>						
gateway operator	local	N	N	N	N	N
LECs providing Internet access	state	N	N	N	N	N
cable companies offering IPT	??	N	??	N	N	N
other ISPs	local	N	N	N	N	N

## Slide 28

**California Compared to Other States**

State	Number of Local Taxes	Number of State Taxes	Total Tax Rate	Number of Tax Bases	Number of Returns
Arizona	3	5	13.13%	18	205
California	2	7	12.28%	17	2,440
Florida	5	5	21.79%	10	4,731
Nevada	6	3	2.89%	7	194
New Mexico	13	8	8.53%	23	120
New York	5	8	17.26%	10	5,623
Oregon	1	4	13.20%	86	1,017
Texas	3	8	28.56%	4	3,107
Washington	8	5	19.26%	12	4,446
<b>NATIONAL AVERAGE</b>	<b>3</b>	<b>4</b>	<b>13.90%</b>	<b>54</b>	<b>1,312</b>

## Slide 29

**Is the burden of the existing tax treatment of telecommunications services and providers distributed equitably?**

- According to benefit principle: No
- According to ability-to-pay principle: No
- According to horizontal equity principle: No

## Slide 30

**Does the existing tax system impose different tax burdens on the providers (or consumers) of similar services? YES**

- Cable and satellite services are not subject to the federal excise tax nor the myriad of federal and state universal service taxes.
- Internet telephony services escape all of these and the local UUT.
- LECs are exempt from franchise fees.
- Telephone companies are subject to state assessment while others, such as cable, are locally assessed.



## Slide 31

**Is the existing tax structure the most efficient means of raising the current level of tax revenue? NO**

- Current system leads to at least a four percent efficiency loss.
- Raising the tax rate on local exchange access and lowering the rate on other services such as long-distance and wireless would reduce this loss.

## Slide 32

**Does the existing tax system distort the consumer's choice between competing telecommunications services and technologies?**

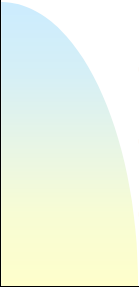
- Economic theory suggests that differences in taxes should influence consumer choices.
- Of greatest interest and concern is the switch to Internet telephony which increased an estimated 300 percent from 1999-2000.

## Slide 33

**Does the existing tax system distort the location decision of telecommunication providers or consumers?**

- Telecommunication costs vary from city to city and from county to county in California
- The Utility User Tax alone ranges from zero to 11 percent.
- Decisions to locate in California are probably not affected, however the specific choice of location within the state by heavy users of telecommunications services is very likely influenced.

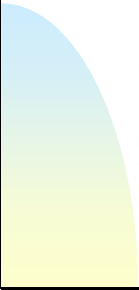
Slide 34



### Recommendations

- Extend the manufacturer's investment credit and sales tax exemption for new manufacturers to telecommunication companies
- Examine the apportionment and sourcing rules as they apply to telecommunications and information services
- Establish new nexus guidelines for the information age

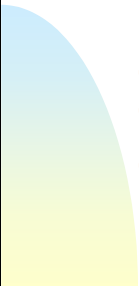
Slide 35



### Recommendations

- Simplify and consolidate the various taxes and charges imposed on end-user revenues by local jurisdictions and the CPUC
- Simplify the local utility user tax
- Provide uniform relief for low-income individuals and households for the UUT
- Provide for uniform assessment of all business property

Slide 36



### Recommendations

- Examine the funding for development and management of public rights-of-way
- Clarify issues regarding internet telephony in general, and cable IP telephony in particular
- Monitor and work with the federal government in its efforts to restrict state and local tax systems

# Taxation of Telecommunications and Energy in California

*The following report was released by Dean Andal, a member of California's State Board of Equalization and a former Republican Assembly member. It calls for major changes in the way state and local governments tax telecommunications and energy.*

*For news coverage of the report's release, see State Tax Notes, Feb. 12, 1996, p. 465.*

## I. What's Wrong?

California's system for taxing telecommunications and energy companies was developed long before technological advances made open competition inevitable. It was designed around a rate-based model for utilities selling one service and possessing a government-sanctioned monopoly. Open competition with multiple telecommunications and energy products offered by many well-capitalized competitors is upon us. Competition benefits the average Californian as it brings high quality, diverse services, lower prices, and extraordinary job growth.

Unfortunately, California's present tax system is a clear and present barrier to achieving these benefits of open competition. This report is designed to address the following disadvantages of California's current system of taxing telecommunications and energy carriers.

### A. Tax System Retards Development of the Information Superhighway

Many have spoken about the development of a predominantly fiber-optic broadband information network that will connect consumers via their computers and televisions to a whole new range of products and services. Without question, the deployment of this network will substantially improve the way Americans learn, purchase products and services, work, communicate, and process all other forms of information in their environments.

Unfortunately, California taxes telecommunications companies in a way as to actually impede the development of such a broadband information network. For example, local exchange carriers were granted a statewide franchise in the early part of this century to develop the telephone network; consequently, they pay no local franchise fees for access to and use of public rights of way. At the time, this was correctly seen as in the public interest because it promoted the goal of universal service. Today, if a local exchange carrier begins providing services other than telephone on a non-common-carrier basis (for example, cable television) the rights of way used for delivery of those services become subject to franchise fees by local government. As a result, the local exchange telephone carriers

are unnecessarily burdened in the development of the network necessary to compete with the cable television companies. For cable television companies, which already pay substantial franchise fees to local government, developing a network capable of competing with the switched network of the local exchange telephone companies becomes inordinately expensive. In the end, Californians lose as the rest of the world continues to promote their telecommunications networks and reap the benefits of the jobs attributable to the system's development and use.

### B. Property Tax System Is Too Litigious and Burdensome

It is difficult to imagine a property tax system that invites more conflict in the assessment process. Both state and locally assessed telecommunications companies have fought county assessors and the Board of Equalization in endless disputes over the value of property (e.g., *GTE Sprint Comm. Corp. v. County of Alameda*, 26 Cal.App. 4th 992 (1994)). The state constitution requires annual assessment of utilities at "fair market value," but also excludes intangible assets from tax. State courts have complicated the assessment process by permitting the assessed value to reflect the presence of intangible assets. Confused? So is everybody else. Taxpayers seek relief from values set by the Board of Equalization and county assessors by administrative appeal procedures and lawsuits. The extraordinary cost of litigation benefits no one but attorneys. The utilities either pay unrealistically high taxes or incur costly legal expense to secure relief. The board and county assessors must spend scarce personnel resources on frequent appeals and legal defense of their assessment methods. Local government receives less revenue at a higher cost than necessary and they are constantly at risk of having to pay substantial tax refunds if questionable assessment techniques are reversed in court. Bluntly, less money is available for schools, police officers, libraries, parks, and all other services dependent on the property tax.

### C. Open Competition Is Discouraged by an Uneven Tax System

Technological change is clearly opening competition for both telecommunications and energy carriers in California. While the Public Utilities Commission (PUC) and the state Legislature advance an open market for these vital services, the existing tax system stands in the way. The best example is the difference between the property tax assessment of cable television and local exchange telephone carriers. Cable television is locally assessed and as a result receives the benefit of Proposition 13's acquisition-based valuation system and annual cap on valuation growth. Cable television companies also pay property tax on the value of their use of the public

rights-of-way (possessory interests), pay a franchise fee to local government of as much as 5 percent on their gross revenues, and are assessed by 58 county assessors who have the constitutional authority to value their property. Local exchange carriers, on the other hand, are not protected by Proposition 13 and are assessed annually at fair market value on a unit basis by the Board of Equalization. They do not pay property tax on the value of their possessory interest for their use of the public rights of way or pay franchise fees. Regulators are expected to allow telephone carriers into the cable television market and cable television companies into the telephone market within the next two years. When this occurs, the telephone companies may balk at providing cable television over existing telephone lines because it opens their entire business to potential franchise fee payments to cities and counties throughout California. The cable companies similarly will be discouraged from competing in the local exchange telephone market because offering local phone service means possible state property tax assessment and loss of their Proposition 13 protection. As a result, cable television property taxes could skyrocket. Who loses? The average Californian, who is prevented from enjoying the fruits of competition: rapid job growth, lower prices, and more diverse and higher-quality services.

#### D. Excessive Utility Taxes Create Poverty

As of fiscal 1994, 17 cities had utility taxes that exceed 8 percent. It's no coincidence that many of these same cities have higher-than-average unemployment rates. Manufacturing plants have a strong incentive to avoid these cities because of their heavy usage of electricity and the threat of millions of dollars in utility taxes they wouldn't need to pay in other jurisdictions. Similarly, financial services companies are avoiding these cities when locating credit card service centers and other telephone dependent "back office" operations due to the high utility tax burdens on heavy phone service. This will only be compounded as the broadband network is developed. Because the broadband network will permit advanced teleconferencing as well as vastly decrease the costs of transferring data, it will become easier and less costly to locate back office and support operations in low-tax jurisdictions. These and other service delivery centers are critical to the employment of unskilled and semiskilled workers in urban areas. Those local governments that have high utility user taxes are discouraging exactly the type of jobs needed for the hundreds of thousands of unemployed Californians who live in these cities.

***Unfortunately, California taxes telecommunications companies in a way as to actually impede the development of such a broadband information network.***

To add insult to injury, these high utility taxes are extremely regressive and disproportionately burden the poor. If the objective of the cities with excessively high utility taxes is to create more poverty — it is certainly working.

#### E. Telecommunications Surcharges Are Abused

Currently, telephone services in California are subject to five separate surcharges: Universal Lifeline, High Cost Fund, D.E.A.F. Fund, Emergency Telephone Users (911), and the

PUC Regulatory Fee. Electric customers also pay the PUC Regulatory Fee as well as the Low Income Ratepayer Assistance and Energy Resources Surcharge. Each of these surcharges represents an effort to fund various social programs that are only tenuously related to the services to which they are attached. In many instances the programs are wasting taxpayer dollars by providing services to those who do not meet program qualifications and by improperly augmenting state general fund spending.

The largest of these surcharges (\$380 million annually) is the Universal Lifeline Trust Fund Surcharge. It is an enormous subsidy intended to ensure that those with low incomes can still afford basic telephone service. Unfortunately, although income guidelines exist for program eligibility, there is no verification of actual eligibility. This has two implications. First, according to the Federal Communications Commission, California, unlike any other state, forgoes approximately \$50 million annually in federal funds conditioned on state verification of eligibility in the lifeline service program. Secondly, the \$380 million subsidy is spent on many who are, in fact, not poor and need no subsidy.

The Emergency Telephone Users Surcharge (911) is an example of how the legislature enacts a special taxing system to fund a specific program then, when budgets are tight and they are unwilling to control their spending, borrow against, or simply rob from, those special funds to backfill the general fund. In fiscal 1994 alone, the 911 program was drained of \$11 million that was intended to upgrade antiquated systems in 25 counties only to be used to backfill general fund overspending. This type of backdoor taxation must stop.

## II. The Solution

In light of the elimination of rate-based regulatory monopolies and the introduction of open-market competition, California must revise its current system of taxation to ensure the competitive development of an advanced telecommunications network. Revamping the current system of taxing telecommunications requires balancing the sound tax policies of economic neutrality, equity, and ease of administration, with the need for state and local governments to maintain revenue stability. Not all distinctions between the taxation of telecommunications companies and other business need to be eliminated to accomplish this: instead, leveling the playing field between market participants in the telecommunications industry will achieve the goals of promoting competition and investment. Leveling the playing field ensures that similarly situated companies will be taxed the same, and can be accomplished without affecting the stability of local government revenues.

California must be on the forefront of the development of the broadband information network and continue to lead the development of new information technologies. To assume this leadership role, Californians should adopt a constitutional amendment creating a single telecommunications tax structure in lieu of the existing property tax and franchise fee system. This new structure will treat all participants the same whether they are delivering telephony or video by fiber-optic or wireless systems. This proposed constitutional amendment will establish a single gross receipts tax at a rate fixed in the constitution. The proposal caps local utility user taxes at a maximum of 8 percent and creates the Universal Telecommunications Sur-



charge (UTS) to fund universal service programs, the 911 program, and the regulatory functions of the Public Utilities Commission, thereby eliminating the current separate rates charged to fund these programs. The Legislature will allocate the funds generated by the new UTS between these service programs and the PUC.

In addition to removing differential taxation as an obstacle to the advancement of telecommunications in California, this proposal substantially reduces the costs to state and local government for administering the property tax system and eliminates the need to separately negotiate and collect franchise fees on a company by company basis. This proposal ensures the replacement of existing revenue streams to local government and offers a dedicated revenue source. *This is not a tax cut, nor does it create a revenue source that can ever be pillaged by the state; in fact, the revenue will be protected from legislative appropriation for other uses in the constitution.* Except for reimbursement of a fixed percentage to cover the costs of administration, the state will receive no revenue from this tax.

Information technology advances are quickly rendering our tax policies obsolete. If Californians fail to recognize that something more than tinkering on the edges must be done, the future jobs linked with an advanced telecommunications industry will slowly move across the border to other states and other nations.

#### ANDAL CONSTITUTIONAL AMENDMENT PROPOSAL

##### 1. Gross Receipts Tax at a Fixed Rate.

(eliminate property tax and franchise fees for telecommunications and energy carriers).

##### 2. Cap the Utility User Tax at 8 Percent.

##### 3. Create the Universal Telecommunications Surcharge.

(eliminate all other surcharges on telecommunications and energy services and prevent establishment of new surcharges).

### III. Taxation of Telecommunications and Energy in California

#### A. Looking to Tomorrow

Roughly two decades into the information age we are witnessing a fundamental shift in our economy and in the way we manipulate and process information. Perhaps most importantly, this shift is predicated on the move to digital technology.<sup>1</sup>

<sup>1</sup>Microprocessors communicate in binary or digital language, which is the rendering of information into combinations of 1s and 0s (or "on" and "off"). A single digit is referred to as a bit. Digitizing something, whether a letter, voice, picture, sound, video, or raw data, is the process of representing the qualities of the object in digital form. Digital technology is important for two reasons: (1) Information rendered in digital form lends itself to easy processing and manipulation; and (2) Digital information can be compressed, which substantially reduces both the storage capacity and bandwidth capacity needs.

Sourcing information in digital form will permit consumers to use information appliances that are designed for the sole purpose of searching for information that is of interest to them, process the information into a meaningful form, and present it for their use and consumption. Rather than wait for the weather report on the local newscast, a computer or other appliance will simply be directed to update the user on the status of the weather. Instead of having to rent or buy the "Star Wars Trilogy" on videocassette, the user will simply select it from a library of videos for viewing on demand. The future in telecommunications is about fulfilling a simple goal: whatever, whenever, wherever, the information you desire will be the push of a button or a voice command away.

For the economy to maximize the benefit of the digital revolution, a sophisticated infrastructure must be installed so that those who provide information can be more directly connected to those who consume it. The next step in the evolution of the information age is the development of a national communications network capable of providing consumers access to countless sources of digitized information from business and financial markets, governments, educational institutions, or the entertainment industry. Often referred to as the "information superhighway"<sup>2</sup> or "national information infrastructure,"<sup>3</sup> the deployment of this network will substantially alter the way Americans learn, purchase products and services, work, communicate, and process all other forms of information in their environment. Because the needed capacity of an advanced telecommunications network is widely believed to exceed that of installed copper-wire systems owned by the local exchange and cable television companies,<sup>4</sup> the new infrastructure will consist largely of fiber-optic cable capable of transmitting thousands of times more data per second than existing copper-wire systems.

The cost of installing this massive infrastructure will be enormous. Some estimates for a national broadband network are as high as \$1 trillion.<sup>5</sup> The necessary investment must be made by the private sector simply because the telecommunica-

<sup>2</sup>This phrase has been popularized by many and often attributed to Vice President Al Gore, whose father sponsored the 1956 Federal Aid Highway Act. Unfortunately, it doesn't really convey the realities of the future of telecommunications. See, Bill Gates, *The Road Ahead* 5 (1995); Nicholas Negroponte, *Being Digital* 231 (1995).

<sup>3</sup>The national information infrastructure, or NII, refers to the policy agenda of the Clinton administration on the development of the broadband information network. This agenda can be retrieved from the White House computer on the World Wide Web at <http://www.whitehouse.gov>.

<sup>4</sup>See Barrett, "Public Policy and the Advanced Intelligent Network," 42 *Fed. Com. L.J.* 413 (July 1990). The number of bits that can be transmitted per second through a given channel or medium (copper wire, radio frequency spectrum, or fiber-optic cable) is the bandwidth of the channel. Bandwidth is important for two reasons: (1) Time is money and transmitting a fax to Hong Kong is cheaper the less time you are "on the air"; (2) To render live digital sound or full-motion video over a transmission channel requires transmission of the samples or frames over the channel in close proximity. If the channel is low bandwidth, the frames will not be rendered at the other end in close enough proximity to appear as live-motion video or sound. Bandwidth becomes less important as compression techniques improve. This is particularly important for the local exchange carriers who have vast installed networks of low-bandwidth twisted-pair copper wires.

<sup>5</sup>"Telephone Company Entry Into Video Services: A First Amendment Analysis," 67 *Notre Dame L. Rev.* 97 (1991), citing R. Entman, *State Telecommunications Regulation: Toward Policy for an Intelligent Telecommunications Infrastructure* 17 (1989).

tions carriers have the most to gain from an integrated broadband network and are much more efficient in their use of capital. The potential returns to industry will fuel a major investment in this infrastructure.

Businesses most responsible for this investment can be loosely defined as the telecommunications industry, composed of local exchange telephone carriers, interexchange telephone carriers, cable television companies, wireless communications companies (including wireless cable and satellite television, cellular, PCS, satellite communications, and paging), and the electric utilities (due to their vast fiber-optic networks that will likely be utilized for the transmission of commercial data). The telecommunications industry is currently experiencing revolutionary change. Spurred by recent deregulation, telecommunications carriers are changing both the nature and manner of delivery of the services they provide. In what the telecommunications industry labels as "convergence," participants are not only moving toward using identical technologies for the infrastructure to deliver information services (the digital fiber optic networks) but also beginning to provide the same or similar types of services across the delivery channel (movies and online services, for example). Within the next few years there will no longer be such a thing as *the* telephone company or *the* cable company. Soon, there will simply be telecommunications providers or telecommunications carriers. Companies will have the capacity to provide a whole range of telecommunications services — from video programming, teleconferencing, local phone service, and long-distance service to integrated wireless communications. The consumer will have a choice of a single carrier provider or a combination of providers at their discretion.

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***State and local tax policies are skewing the choices available to consumers by making use of certain channels for information delivery more expensive than others.***

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At the same time, state and local governments cling to antiquated models of regulation and taxation of the telecommunications industry that are hampering the new competitive environment and retarding the development of the advanced information infrastructure. Government's preoccupation with the past unfortunately blinds it to the realities of the future in telecommunications. Nowhere is this more apparent than in California's system of taxing telecommunications companies.

Unlike any other competitive industry, telecommunications companies have been singled out for special treatment and extra taxation. Special treatment was historically justified, and admittedly tolerated by the companies themselves, due to their status as rate-based regulated public utilities. That status also provided the company special rights and privileges as a monopoly franchise. The taxes paid by the public utilities were built into and recovered through the rate base. Even among the telecommunications carriers are subindustries that are taxed differently than their competitors based solely on the technology they employ for the delivery of information. This has the negative effect of favoring one type of competing technology over another, a decision that should be left to the marketplace.

Advances in digital technology, both in transmission and compression, have rendered obsolete any distinction between the channels used for the delivery of information to the consumer. A packet of digital bits traveling through the spectrum, over a copper-wire or fiber-optic cable, whether it delivers a letter, a video, sound, voice, or data, is simply a packet of digital bits.

Ultimately, the choice of one medium over another for transmitting information should be decided based on individual preferences and the merits of the given medium. Unfortunately, state and local tax policies are skewing the choices available to consumers by making use of certain channels for information delivery more expensive than others. The result is hampering the development of the information superhighway and needlessly impeding the development of telecommunications technologies. If left to the marketplace, the natural costs of using a given channel for transmitting will be solved by supply and demand rather than the arbitrary hand of government. Roadblocks to open competition created by California's antiquated tax system retard higher quality services and obstruct lower prices offered by new carriers of telecommunications products and services.

## **B. Overview of Taxes**

The taxation of telecommunications companies in California, aside from the corporate franchise (income) tax and the sales and use tax, is composed of property taxes, franchise fees, utility user taxes, and various surcharges that fund special social programs only tenuously related to telecommunications services. The property tax is highlighted by a bifurcation between property values established by the State Board of Equalization (state-assessed property) and those set by the county assessor (locally assessed property). Although state assessment has the benefit of providing the large, multijurisdictional utilities with a single government agency to administer the property tax, it also means its property is valued annually at market because it receives no protection under Article XIII A of the California Constitution (Proposition 13). State-assessed property is also valued on a unit basis (the concept of valuing a company's taxable property as a going concern, as opposed to simply summing the individual values of the company's tangible assets). Not only does this create a substantial burden on state assesses, as the unit method arguably taxes intangible property in violation of the law, but it also is a barrier to entry for cable television interests and other non-state-assessed taxpayers who wish to provide telephony services but not risk subjecting their entire company to annual assessment at full fair market value and unit valuation.

Franchise fees, paid by cable and gas and electric companies, are a charge for the privilege of engaging in specialized services as well as for the right to use public rights of way to lay their cables. Although local exchange carriers (LECs) and cable television companies are laying similar lines beneath public rights of way, the LECs have been exempted by the state from paying franchise fees. While this produces the inequity of taxing cable television companies while not taxing the LECs, it has the more dramatic effect of delaying if not preventing the LEC's ability to compete in the cable business because such competition by the LECs would arguably eliminate their state franchise exemption.

The utility user tax is a passthrough tax that is paid by the utility services as a percentage of their bill, which has been as

## 911

[illegible]



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May 22, 2003

The Honorable William Rosendahl  
Chairman  
California Commission on Tax Policy in the New Economy  
1102 Q Street, 6000  
Sacramento, CA 95814

Dear Chairman Rosendahl:

This letter is in response to a letter I found addressed to you from a Mr. Eric A. Daniels, Director, State and Local Governmental Relations, of the California Space Authority dated December 16, 2002. I found this letter on their website and was concerned about some of the inaccuracies it contained. Mr. Daniel's letter, which addresses his concern that your commission would recommend the taxation of satellite television services, is attached for your reference.

I work for a consulting firm that serves government agencies, and I have spent considerable time auditing cable operators and other utility providers on behalf of those government agencies. The information I am providing is based on this experience.

First, the franchise fee, by FCC regulation, can be up to but not exceed 5% of the cable operator's gross receipts. This fee is considered to be a cost to the cable operator for the use of the public right-of-way. The FCC allows the cable operators to reflect the recovery of the franchise cost as a direct line item on the cable operator's invoice to their subscribers instead of recovering those costs by including them in their charges for services. Mr. Daniels indicated that the franchise fee is "much like a business license fee". It is not. A business license fee is a tax for the privilege doing business in a city. A franchise fee is not a tax, but rather is compensation to the city for the use of its right of way.

Mr. Daniels stated, "It [franchise fee] is really a fee paid to local government to be the exclusive provider." To date, I have never seen a franchise agreement with a cable operator that entitled that cable operator to be an exclusive provider. In fact, such franchise agreements all stated explicitly that it is a non-exclusive agreement.

Mr. Daniels states, "Sales taxes are also collected for the sale of any equipment purchased for satellite television use, unlike cable boxes that are merely rented by the cable operator." What Mr. Daniels failed to mention was that the cable operator is required to pay a sales or use tax on the equipment that they rent to subscribers. The cable operator can either choose to pay the sales tax on the equipment at the time of purchase, or collect a use tax from their subscribers on the rental charges of that equipment.



Mr. Daniels' understanding of local government's utility users taxes is also incorrect. He states: "This is a tax [utility users tax] imposed by the local government against all privately operated utility providers. It is paid to local governments for the privilege of cutting up the streets now and then when service is needed on various utilities that are in the streets."

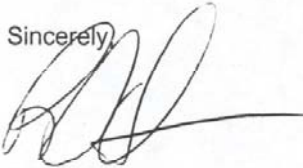
First, utility users taxes are imposed on the customer, and not on the provider. The utility provider is merely the collector of the tax from their customers. Second, the utility users tax is normally a general fund revenue used to fund police, fire and other essential services in the community. The utility users tax is not for the privilege of cutting streets.

For your information, in California, eighty-two local governments apply their utility users tax to cable / video services. The utility users tax rates applied to cable / video services are between 1% and 11%, with an average rate of 5.51%.

Also, 152 cities and counties have utility users tax ordinances, which generate approximately \$1.2 billion in local revenues. For some cities, the UUT represents as much as 25% of all tax revenues. In a growing number of cities, the UUT ordinance has been approved by the electorate. You can obtain specific information regarding the various UUT ordinances at [www.uutinfo.org](http://www.uutinfo.org).

I hope the foregoing information is of assistance.

Sincerely,

A handwritten signature in black ink, appearing to read 'Randy Dryden', with a long horizontal flourish extending to the right.

Randy Dryden  
Director of Product Development

Attachments